JULY 1961

The Controller

EDITED FOR CORPORATE CONTROL & FINANCIAL OFFICERS

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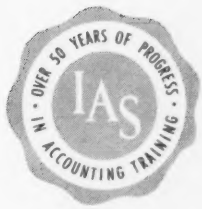

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THERE IS A FUNDAMENTAL ERROR IN ABSORPTION COSTING

Editors, THE CONTROLLER:

It is not difficult to agree with Dr. A. W. Patrick when he states in his article on "Direct Versus Absorption Costing" in the April 1961 issue of THE CONTROLLER that "any accounting method should stand or fall on its logic, usefulness, and general acceptance. In order for direct costing, in its proper technical sense, to be generally accepted as a valid accounting procedure, it must be justified on the basis of the above criteria. . . ."

But it is difficult to agree with the added phrase, ". . . independent of any comparison with absorption costing," particularly when it appears in an article which is largely devoted to comparing the two costing methods in an effort to defend absorption costing.

One might ask Dr. Patrick: *How is it possible to meet your call for a definition of direct costing which clearly distinguishes it from absorption costing without comparing the two costing methods?*

Actually, of course, it is not the comparison of direct and absorption costing which the defenders of absorption costing dislike; it is the criticism of absorption costing which results from such comparisons. What they are asking for is peaceful coexistence—one more unresolved area of accounting practice.

But if direct costing is a proper practice, then absorption costing is an improper practice, and vice versa. I can see no useful purpose in ignoring this fact. I happen to believe that there is a fundamental error in absorption costing and that direct costing corrects this error. The best way to point this out is to compare the two costing methods, which is what I intend to do. In so doing I shall restrict my comments to the basic difference between absorption costing and direct costing—the way in which each measures periodic income.

What Direct Costing Is and Is Not. Direct costing, like absorption costing, is a method of measuring income. Under both methods costs are matched with revenues by time period to determine periodic income. Under direct costing the matching process is based on the distinction between direct or variable cost and period or fixed costs. Under absorption costing the matching process is based on the distinction between manufacturing and nonmanufacturing costs.

It may also be helpful to point out what direct costing is not: It is not primarily a separation of fixed and variable costs, although this is basic to direct costing, but not to absorption costing. It is not a new or different method of developing costs for decision-making, but it does result in putting historical costs and planned costs on the same basis, thus facilitating planning and comparison of results with plans. It is not an improved form of income report, for you could conceivably prepare from absorption costing figures an income statement which would reveal the cost-profit-volume relationship if you were willing to append at the end of that statement a figure labelled "Profit (or Loss) resulting from increase (or decrease) in inventory." It is not a method of inventory "valuation," but a method of determining what costs are properly deferrable in inventory. And finally, it is not a separation of product costs and period costs, if by product costs are meant all costs which can, by the use of numerous assumptions and prorations, be assigned to a product. No, direct costing is none of these. Basically it is a method of determining income, but because income measurement (be it past, current, or prospective income) is the basic problem of accounting, direct costing does have an influence on the way costs are developed for all purposes.

The Case Against Absorption Costing. Let me state and then illustrate the case against absorption costing as a method of income determination. Absorption costing results in an overstatement of income when production exceeds sales and an understatement of income when sales exceed production. It produces these results by deferring fixed manufacturing costs in inventory—by carrying forward, for ap-

(Continued on page 316)

DO YOU AGREE *or do you disagree with an article in this month's issue? Your fellow readers will be interested. Naturally, letters to the editor must bear the writer's signature and address; these will be withheld on request. The Editors*

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2. To compare performance with operating plans and standards, and to report and interpret the results of operations to all levels of management and to the owners of the business. This function includes the formulation and administration of accounting policy and the compilation of statistical records and special reports as required.

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plication against future revenue, costs which are applicable to the current period.

This is demonstrated by the following illustrations based on the figures and comparative income statements in Dr. Patrick's article. To clearly illustrate the point, I have shown first what he calls year 3 (when sales and production are in balance), followed by his year 1 (when production exceeds sales by 1,000 units) and added a third year based on his figures (to show what happens when sales exceed production by 1,000 units). *Profits on Production.* These figures illustrate what happens under absorption costing when there is a difference between production and sales volume. *How do the defenders of absorption costing explain and justify these results?* According to Dr. Patrick:

"They believe that the results portrayed are correct and reflect the theory that profits are a function of production, or lack of it, as well as sales."

A neat phrase, "profits are a function of production," but *what does it mean? Does it mean that the profits realized and computed after a sale is made can be attributed to production efforts as well as to sales effort?* I can agree with this viewpoint, but it does not justify the results in the example. Or, *does it mean that profits are earned by the act of production and should be recognized at the end of the production process?* This meaning would justify the results in the example, but *how many accountants and businessmen will agree that a profit can properly be recognized before the product is sold?* And *how many will accept the way in which this profit is calculated under absorption costing?* On the 7,000 units produced and sold the company has a reported profit of $24,000 or $3.43 per unit. On the 1,000 units produced but unsold reported profit is $6,000 ($7,500) or $6.00 ($7.50) per unit. *How can we justify a reported profit of $3.43 on units sold, and $6.00 or $7.50 on the units unsold?* Either there is something wrong with absorption costing or the case company should stop selling and spend all its time producing. It will make more profit that way—reported profit, that is.

Just to tie down this argument let us assume that you, the reader, have agreed to purchase this company based on the capitalized value of the profits for the middle year shown. *Would you be willing to include in the base used in computing the purchase price the $6,000 or $7,500 "profit" which has resulted from the production of 1,000 units for inventory?* Of course you wouldn't. It is a phantom profit produced by absorption costing. Nor would the seller, knowing all the facts, be willing to sell on the basis of the profits reported for the third year when profits have been reduced by $6,000 or $7,500 as a result of liquidation of inventory in which past fixed costs have been deferred.

COMPARATIVE INCOME STATEMENTS

	Practical Capacity	*Average Activity*		*Direct Costing*
7,000 units produced, 7,000 units sold				
Sales	$315,000	$315,000		$315,000
Less Cost of Sales	273,000	283,500		231,000
Gross Margin	$ 42,000	$ 31,500		$ 84,000
Less Activity Variation	18,000	7,500	Less Fixed Costs	60,000
Net Income	$ 24,000	$ 24,000		$ 24,000
8,000 units produced, 7,000 units sold				
Sales	$315,000	$315,000		$315,000
Less Cost of Sales	273,000	283,500		231,000
Gross Margin	$ 42,000	$ 31,500		$ 84,000
Less Activity Variation	12,000	—	Less Fixed Costs	60,000
Net Income	$ 30,000	$ 31,500		$ 24,000
Increased Profit Reported Due To Production of 1,000 Units For Inventory	$ 6,000	$ 7,500		
6,000 units produced, 7,000 units sold				
Sales	$315,000	$315,000		$315,000
Less Cost of Sales	273,000	283,500		231,000
Gross Margin	$ 42,000	$ 31,500		$ 84,000
Less Activity Variation	24,000	15,000	Less Fixed Costs	60,000
Net Income	$ 18,000	$ 16,500		$ 24,000
Decreased Profit Reported Due To Liquidation of 1,000 Units From Inventory	$ 6,000	$ 7,500		

Influencing Reported Profit. Perhaps as you have pondered the above questions you have come to realize how easy it is for management which understands absorption costing to influence reported profits. Reported profits for a period can be increased by the fixed costs absorbed in every unit added to inventory and reduced by the fixed costs liquidated by every unit in the reduction of inventory. But, by the same token, management which does not understand how absorption costing works (and *how many accountants using absorption costing are able or willing to provide this understanding?*) can be seriously misled by profit results similar to those shown in the illustration.

The use by Dr. Patrick in his article of two different capacity levels for the absorption of fixed costs under absorption costing illustrates another serious defect of this costing method. The level of profit reported is determined by the level of capacity or volume used in absorbing fixed costs and there is no objective way of determining what is a "proper" level. Profits are determined by management's decision as to the level or volume to be used.

It seems rather ironic, when one considers all the attention which has been paid over the years to the elimination of unrealized profit in connection with intracompany transfers, that equal attention has not been given to the elimination of the unrealized profits (and losses) which are created by the use of absorption costing. The same income-realization principle is involved.

The Error in Logic. Having illustrated what happens under absorption costing, let's see if we can pin down the error in logic that causes this sort of error. Many accountants are inclined to argue that fixed manufacturing costs are as much a cost of the product as are variable manufacturing costs. Dr. Patrick states it this way:

"The proposition that costs should not be charged to products simply because they are fixed does not seem logical to this writer. Such costs are incurred to make possible the production of goods, and it takes a considerable amount of stretching to jump to the conclusion that to the extent the machine is used to produce a product a pro rata portion of the cost of the machine is any less a proper product charge than is the wage of the direct laborer who operates the machine."

This is the sort of reasoning which results from failure to understand the real difference between variable and fixed costs. *What makes a manufacturing cost variable?* Its direct association with the product to which it applies. The direct material, direct labor, and variable over-

(Continued on page 318)

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head costs of a product come into existence because the product comes into existence. Without the product you would not have the costs. With the product you will not need to incur these same costs for this unit in the future. So they can be deferred and carried forward until the product is sold.

What makes a manufacturing cost fixed? The fact that it arose without reference to or as a result of any particular unit of production. Because it is a committed, planned, or readiness-to-serve cost—a cost which the business will have to bear whether or not the unit in question is produced or not—a cost which will not be reduced in a subsequent period because part of it was applied to a product in this period. *Doesn't it take a considerable amount of stretching to jump to the conclusion that costs which are charged against the period when the capacity is not used can, by some accounting legerdemain, be transferred into effective and deferrable product costs when management decides to use, as compared with not use, the provided capacity?* Such decision does not increase these costs, nor does it reduce the costs of future periods.

The Difference Illustrated. Let me illustrate by an example. Both Company A and Company B manufacture Widgets, Company A by manual methods and Company B on automatic machines. As we reach the last two days of the month the Widget business is at a standstill. Neither company has an inventory and neither company produces any Widgets on the next to the last day of the month. But the costs of the two companies are different. Company A has no labor cost, but Company B continues to have depreciation, taxes, insurance, and other costs relating to the Widget machines which have replaced manual labor, costs which go on day after day, whether any Widgets are produced or not. There is a difference between direct labor costs and the fixed costs of the machines which replace the labor.

On the last day of the month in anticipation of sales during the following month, both companies begin production of Widgets. In Company A the production of a number of Widgets results in added labor costs which would not have been incurred if the Widgets had not been produced. So these costs are charged to the Widgets and deferred in inventory for application against revenue when the Widgets are sold. Having incurred the labor cost of production this month, it will not be necessary to incur this cost in the future when they are sold.

But in Company B the production of Widgets does not change the fixed machine costs which have replaced the labor costs. These go on day by day relentlessly, whether there is any production or not. So, if we apply any of these fixed costs to the product and defer them in inventory, we relieve the period of the amount of fixed costs deferred, thus increasing the reported profit for the month, and we carry these inventoried fixed costs forward to the next month during which depreciation, insurance, taxes, and other fixed costs on the machinery continue day after day. Yes, there is a difference between direct labor costs and the fixed costs of the machines which replace it, and it is the failure to recognize this difference which causes absorption costing to improperly measure periodic profits whenever production and sales volume are not in balance.

There remains one other point in theory and terminology which needs to be clarified. In his article Dr. Patrick makes the statement:

"The basic issue is a theoretical one which is concerned with the proper classification of costs into product costs and period costs."

The error in this statement is in the use of the term "product costs" and its interpretation by proponents of absorption costing. To them product costs include, in addition to direct costs of the products, any portion of the period (fixed) costs which can by accounting magic be allocated to the product. They think of fixed manufacturing costs as period costs when the capacity these costs provide is not used, but as product costs to the extent that the capacity is used.

Let me attempt to demonstrate the fallacy in this viewpoint. Assume a multiproduct company which has one bank of machines used only in production of Product A. The depreciation, insurance, taxes, and other costs caused by these machines are assignable to Product A—they represent one of the costs of manufacturing Product A, whether you classify them as product costs or period costs. But they do not represent direct costs of Product A—costs which come into existence when Product A is produced, vary with the number of units produced, and disappear when there is no production. Therefore, they should not be unitized, charged to the product, or deferred in inventory. Rather they should be recognized as fixed or period costs of Product A, deductible on the Product A income statement from the marginal income to determine the contribution which Product A makes to those fixed or period costs which are common to the business as a whole. In other words, it is not necessary to apply a cost to a product and defer it in inventory to treat it as a cost of a particular product or product line. So the problem, as I see it, is not "the proper classification of costs into product costs and period

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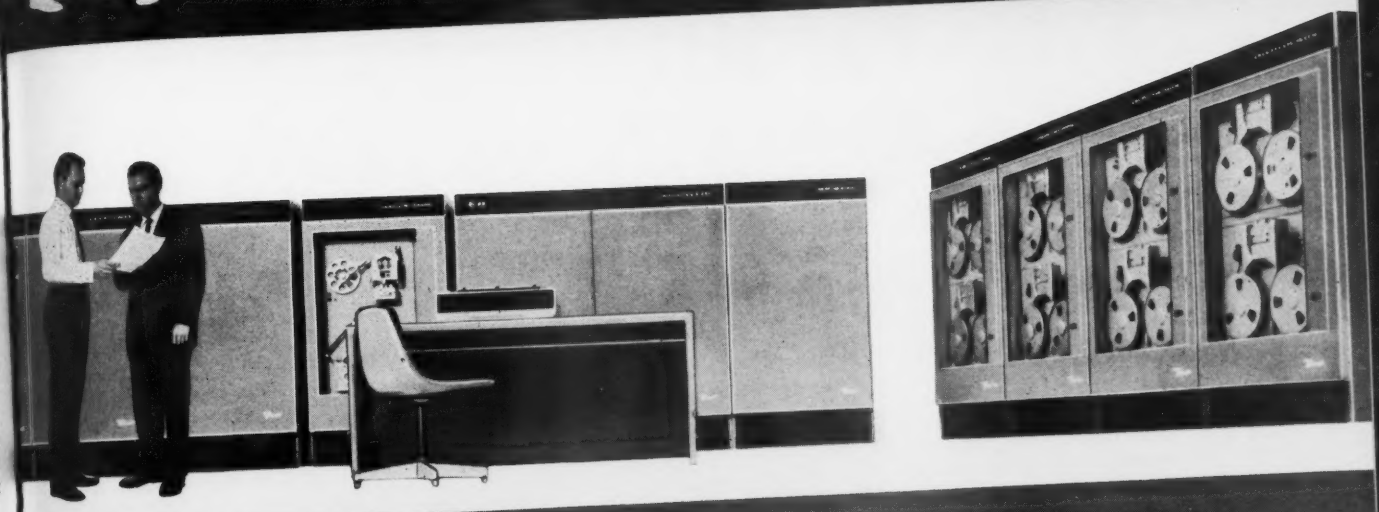

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costs," but the proper classification of costs between direct (deferrable) costs and period costs.

Conclusion. The purpose of this letter has been to point out the fundamental error in absorption costing as a method of income determination and the reason for the error. By so doing the logic of direct costing has been presented. The basic difference between the two methods is that absorption costing results in the deferral in inventory of fixed manufacturing costs, while direct costing does not. Since it is this deferral which results in the distortion of reported income under absorption costing, its elimination under direct costing removes the distortion.

But one final word: The modern management accountant is equally concerned with past, present, and future costs. Yesterday's costs are used in planning tomorrow's costs, and these planned costs are used in controlling today's current costs. For cost planning and cost control the accountant needs to separate and provide separate treatment for those costs which vary with volume and those which do not. Direct costing places past costs on the same basis. For this reason, while direct costing is not a new method of cost control or cost planning, it does facilitate and improve both cost planning and control, at the same time as it improves profit measurement. Once accountants generally recognize this, direct costing will replace absorption costs for both internal and external reporting. In this area there is no justification for peaceful coexistence of the two methods.

RAYMOND P. MARPLE
Assistant Secretary
National Association of Accountants
New York, N. Y.

A DIFFERENT REACTION

Editors, THE CONTROLLER:

I read with great interest the article in the April issue of THE CONTROLLER on "Direct Versus Absorption Costing," by Dr. A. W. Patrick. For the past several years I have been conducting a mild campaign in an effort to provide balance to the publicity which has been actively promoted by the proponents of direct costing. Dr. Patrick's article, I feel, does an excellent job of pinpointing some of the fundamental distinctions and clearing up a great deal of the existing confusion.

My own feelings are very much against indiscriminate direct costing simply because I refuse to honor the assumption of direct costing proponents that management is uninformed and therefore has to have a much simpler cost mechanism for control purposes. My own feelings are that a properly developed set of reports based on absorption costing need not be confusing. Moreover, from rather extensive practical experience in cost work I have never found it difficult to provide management with clear and easily understandable reports based on a fully developed absorption cost system, even though I must admit the development of such a system may have been difficult and complex.

HENRY KEYSERLING
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LITTLE BOUQUETS . . .

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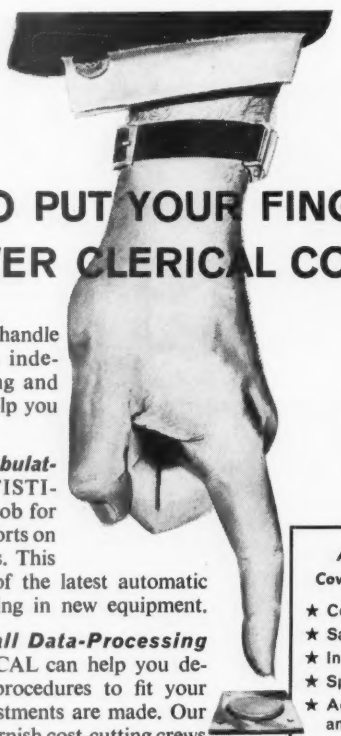
DGT, Saskatoon, Saskatchewan.

MERGER MATERIAL

Editors, THE CONTROLLER:

Can you give me any help in locating material having to do with mergers, reorganization of the combinations, and tax problems evolving therefrom?
LT, New York

Seventeen selected references compiled by Controllers Institute Research Foundation entitled "Corporate Acquisitions" *were published in the July 1958 issue of* THE CONTROLLER, *page 340. The list comprises periodicals, pamphlets and books containing such material.—The Editors.*



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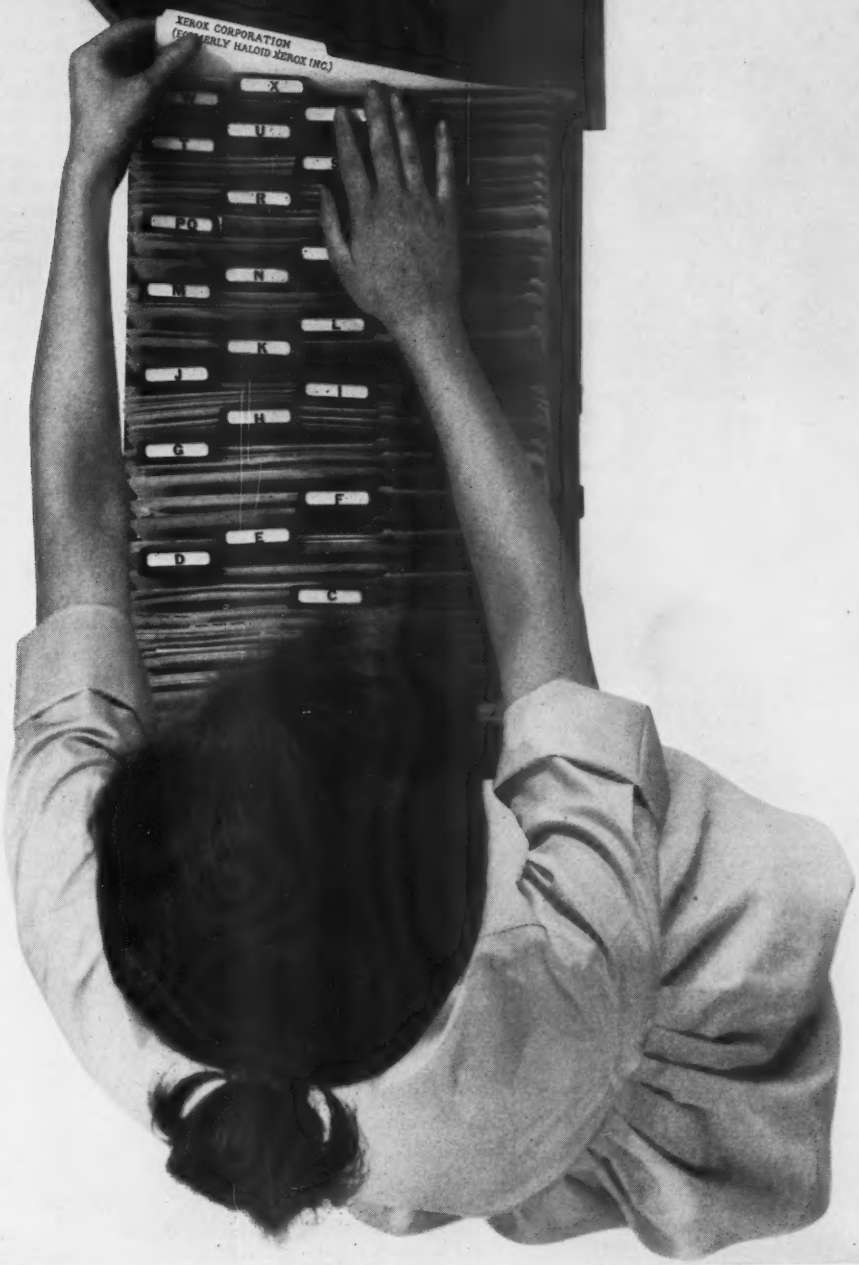
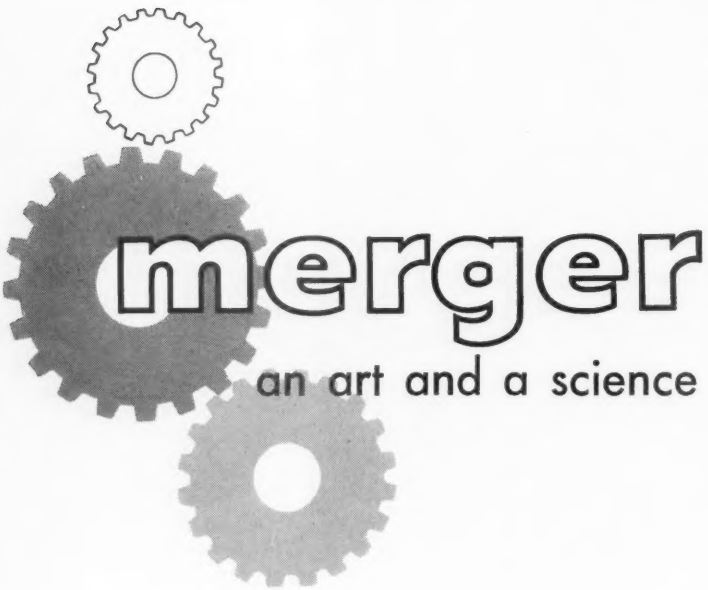


XEROX
CORPORATION

On June 1 the name of our company changed from Haloid Xerox Inc. to XEROX CORPORATION. Therefore, you will want to bring **your** reference files up-to-date. Then, when you're looking for information on office copiers, high-speed continuous printers and other reproduction equipment, you will find it—under "X." ■ Why this curious name "Xerox"? The word is of classic origin and stems from the Greek **xeros,** meaning "dry." And **dry** describes, perhaps as well as one word can, the revolutionary process on which our copiers and printers operate. ■ The initial "X" in all English words of ancient Greek origin is pronounced as a "Z." Hence, Xerox is pronounced **zerox** . . . but here we part company with all things ancient and Greek! ■ For the Xerox in our new corporate name stands for a modern, progressive, research-oriented company which, through exciting new products, is making its mark in the growing field of graphic communications. ■ In meeting the needs of modern business for better ways to record, condense, store, and recall the sheer mass of information, XEROX CORPORATION helps management to manage the future. For more information on our company, write XEROX CORPORATION, 20 Haloid Street, Rochester 3, New York.

merger: A DUAL FEATURE



Two authors discuss the factors which must be taken into consideration to accomplish a successful merger, each emphasizing a different aspect of the dual elements of the art and science of merger.

William E. McKenna, beginning on this page, examines the art of merger—common sense and financial acuity applied to company growth through acquisition.

Roger R. Crane, on page 326, considers the place of scientific techniques in mergers and acquisitions—mathematical formulae and projections to back up intuition with scientific analysis.

AT THE TURN of the century, a rash of vertical and monopolistic mergers of American corporations invited public indignation and led to stronger anti-trust legislation. During the intervening decades we have witnessed several periods of industrial combinations—but none so interesting as the latest. What may be called the most dynamic and constructive period of merger started about the mid-point of this century and shows no signs of abating as we move into the sixties.

There are those who view the situation with alarm, fearful that a new era of combinations will destroy the system of competition which has brought our commerce and industry to present-day heights. *(Is it not odd that those same alarmists, for the most part, show not the slightest concern over the freewheeling growth of big labor and big government?)*

Their disquiet is probably unnecessary. The Sherman Act and the Clayton Act are on the books now to protect the public from any misuse of power resulting from the accumulation of wealth. World competition in this jet age should prove to be a stronger force than ever in protecting the public, and in fact, merger may be the means to meet that competition for many of our smaller corporations.

Today efficiency is often closely tied to size. In many industries a tremendous sales volume is necessary to promote peak manufacturing efficiency and provide the vast sums necessary for competitive research in a one-world industrial economy. Thus, while unrestricted merger activity in the last century may have tended to reduce competition, properly directed merger in the second half of the century can be a vehicle for preserving competition between space age industries within the United States and a necessary force for keeping United States industry competitive in the world economy.

When we get down to the specifics of mergers, the basic questions are, of course: *Is the proposed merger a good one? Does a combination of the companies involved make sense?*

Answers to these questions involve the long-range corporate plans of the merging corporations, their products, the capability of the merging managements, and the effectiveness of their respective research, manufacturing, and marketing organizations. *How well do the merging companies "fit"? Will some new additional values arise by putting the two companies together?*

In short, *can two and two be made to equal five?* If they cannot, then a merger falls short of its goal. All that is being accomplished is propagation of numbers. No plus value arises.

Simple diversification is no cure-all for corporate aches and pains. It is certainly

not the answer when you are running away from a problem. Nor is it true that, because management is competent in one area, it will prove equally competent in another and different area.

There are many "types" in the field of acquisition. Some of the more outstanding species may be identified as follows—

The Frightened Hedge Hopper—he is hedging a nongrowth activity which he now manages.

The Omnidirectional Equestrian—he rides off in all directions to impress his stockholders.

The Glamour Worshipper—he listens to any new theme.

The Negative Compounding Multiplier—he makes acquisitions for the sheer numbers involved.

The Crowd-Following Competitor—he just wants "to keep up with the competition."

In contrast to these, the people at Litton Industries have entered into mergers and made acquisitions on the basis of the same concept which motivated the firm's founding: *The determination to establish a major industrial entity having, at its heart and core, a superior capacity in advanced technologies.* To do this in a competitive environment, Litton has recognized, requires complete dedication and, most of all, a respect for time.

Litton's growth has not been one of circumstance; it has been planned. Based on the concept just cited, certain specific philosophies have played important roles in the firm's expansion.

Integration, not diversification; strength, not size.

Research as it might lead to production, not research for its own sake.

Everything in balance.

Operating under its original long-range program, Litton now is a complex of companies composed of five major operating groups. How the firm's concept of healthy growth has been implemented—and, more specifically where a respectful evaluation of time has entered into the picture—is illustrated by the most publicized of the Litton acquisitions.

Part of the original program was to become a factor in the business-machines industry. Litton already had developed techniques, circuitry, programming abilities, and components easily adaptable to business computers. However, it would have required vast sums of money, different and hard-to-get managerial talents, and the building up of a commercially oriented sales and service organization—at home and abroad—for the firm to compete in this industry. All this spelled time, and time can mean lost opportunity, lost profit, and lost growth.

The conclusion was inescapable. Litton "bought" time. The Monroe Calculating Machine Company was acquired to become the base of Litton's business-machines group.

COMMITTING THE MERGER

Assuming that the "fit" has been established—that the question of the soundness of the merger has been answered affirmatively—*how does management set about effecting the merger in such a way as to create as many plus values as possible in the combination?* It is here, perhaps, that the controller's responsibilities and opportunities for accomplishment are greatest.

Once it is determined that the deal makes sense, many details must be reviewed in determining the price; the method of payment; the financial, legal and tax considerations; as well as the many psychological problems which must be resolved so that in the ultimate combination all talents and abilities are recognized and realized and nothing falls through the slats.

As we approach a merger, it is important that the financial and legal departments of the corporation work closely. This is necessary because of the fact that there are many problems with both financial and legal overtones. For example, an acquisition may appear to be ideal from a financial standpoint, but legal counsel may conclude that it should not be consummated because of possible anti-trust problems.

The tax and accounting problems of a merger are so important that some "feeling" for them is highly desirable on the part of all who are directly concerned in the matter, including operating personnel. On the other hand, these problems sometimes become so complex that often it is necessary to obtain the most expert accounting and tax opinion in order to resolve them.

However, as controllers and probably not tax experts, for us it is most important that we have a better-than-average appreciation of the tax factors involved in acquisition transactions.

TAX CONSIDERATIONS

Mergers may be made to promote diversification, increase manufacturing capacity, round out product lines, buy time in the development of marketing organizations, increase the corporate base for competitive reasons, or from any of a wide variety of other motives. Taxes, however, are seldom nowadays among those other motives.

In the past some mergers came about solely because of a tax loss situation. But in recent years, particularly since 1954, utilization of tax-loss carry-backs and carry-forwards has been greatly limited by the Treasury Department. Thus a profitable company cannot simply buy a nonprofit company and use the tax credits.

However, if taxes are no longer an important motivating factor, they still play an important part when it comes to implementing the merger.

Generally, an acquisition by a corporation of assets or stock of another corporation is taxable unless it qualifies as a reorganization as defined in Section 368 (a) (1) of the Internal Revenue Code. A statutory merger or consolidation is an *A* reorganization. A loose or improper use of the term "merger" has often caused much confusion. Briefly, a merger is a transaction in which one corporation absorbs another, thus continuing its own existence while cutting off the corporate life of the other.

A "consolidation" is a transaction in which two or more corporations join together to form a new corporation which, in effect, absorbs the other corporations.

An *A* reorganization may be achieved only by strict compliance with the applicable corporate laws of the respective states of incorporation. These may often prove to be quite burdensome. For instance, under the laws of most states a majority vote of the stockholders of both corporations is required. This means the holding of formal stockholders' meetings, proxy solicitation, expenses, preparation and filing of proxy statements, and

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other formalities required by the SEC and the stock exchanges. Dissenting stockholders usually have the right to demand and receive the appraised value of their shares in cash.

These requirements can be troublesome in mergers of publicly held corporations but are not a serious problem where the acquired corporation is closely held and the acquiring corporation is a subsidiary of a holding company.

A *B* reorganization involves the acquisition of a controlling stock interest (at least 80 per cent) in another corporation in exchange solely for the acquiring corporation's voting stock, either common or preferred. In this case, the selling corporation remains intact, becoming a subsidiary of the purchasing corporation.

The stock issued under a *B* reorganization must be registered under the Securities Act of 1933 or investment letters must be obtained from the sellers signifying that they intend to hold the stock acquired in the transaction as an investment. Registration or investment letters may not be necessary if the transaction can be brought under the complex and seldom applicable provisions of the "exchange" exemption under Section 3 (a) (10) of the Securities Act. This exemption applies to a transaction in which an official state agency, authorized by law to do so, approves the fairness of the terms and conditions of the exchange after a hearing at which all persons to whom the securities are to be issued have a right to appear. Further, it is the SEC's position that Section 3 (a) (10) exempts only the transaction of the exchange; subsequent resales of the securities are not exempted.

Registration can be expensive for the purchaser. However, it is unlikely that the sellers are willing to be hampered by the restrictions imposed by not registering.

In a *C* reorganization, substantially all the assets of one corporation are acquired in exchange solely for voting stock either of the acquiring corporation or of a corporation which controls the acquiring corporation. In this case cash or other property can be given without destroying the taxable nature of the transaction, provided the cash or other property, plus liabilities assumed by the acquiring corporation, does not exceed 20 per cent of the market value of all the transferrer corporation's property.

A *C* reorganization does not require registration of the stock issued nor investment letters from the sellers if it meets certain complex requirements established by SEC Rule 133. Furthermore, the assets and liabilities acquired by the purchaser may be specifically identified, thus restricting the possibility of his being later subjected to substantial undisclosed liabilities. This is particularly advantageous in the case of a company that had not been consistently audited over the years or that has several tax years still open.

"Gentlemen, the First National, American, Second Union, Security-Trust Savings Bank can't STAND another merger—people can't remember our name NOW!"

(Courtesy of the Wall Street Journal)

From the buyer's point of view, a taxable transaction is generally desirable in cases where the purchase price exceeds the adjusted tax basis of the assets acquired. A nontaxable transaction is preferable in cases where the acquired corporation has certain desirable tax attributes such as net operating loss carry-overs or high-basis, low-value assets which the acquirer desires to preserve and utilize.

From the seller's point of view, the most important consideration is, of course, that the exchange or "sale" be tax free.

In order to assess the possibilities of obtaining a stepped-up basis, or of making carry-overs available (both matters of great importance to the buyer), the following rules apply:

1. In a taxable acquisition of assets, a step-up in basis may be obtained but carry-overs are not available.
2. In a nontaxable acquisition of assets, a step-up in basis may not be obtained but carry-overs are available.
3. In a taxable stock acquisition, followed by adoption within two years of a plan of liquidation of the subsidiary, if the subsidiary is in fact liquidated within two years following adoption of the plan, a step-up in basis is obtainable but carry-overs are lost.
4. In a taxable stock acquisition followed by the adoption after two years of a plan of liquidation, a step-up in basis is not obtainable but carry-overs are.
5. In a nontaxable acquisition of stock, no step-up in basis may be obtained but carry-overs are available.

The most important sections of the Internal Revenue Code affecting tax loss carry-overs in acquisition are Sections 269 and 382. Section 269 provides that if the principal purpose of acquisition is evasion or avoidance of federal income tax by securing the benefit of a deduction which such corporation would not otherwise enjoy, then such deduction shall not be allowed. This section, together with the proposed regulations, seriously limits the ability of a corporation to carry over the operating loss of acquired corporations or to carry over and offset its own operating losses against earnings which have been created by the tax-free acquisition of the other business. However, in the case of the statutory merger of two subsidiary corporations of a common parent, it would appear that the operating loss carry-over of one of the subsidiaries can still be offset against the income of the other.

Section 382 (a) provides that operating loss carry-overs shall not be allowed if (1) there has been a 50 per cent change in ownership of a corporation's stock as a result of a taxable transaction and (2) such corporation has not continued sub-

stantially the same business as that conducted before the change in stock ownership. Still another hurdle is created by Section 382 (b) which provides for a reduction in the net operating loss carryover to the extent that the shareholders of the loss corporation wind up owning less than 20 per cent of the fair market value of the stock of the acquiring corporation.

ACCOUNTING FOR ACQUISITIONS

The accounting aspects of business acquisitions have continually presented serious problems to acquiring companies, and in dealing with these problems considerable change in presentation emphasis has taken place, particularly where the transaction has been substantially for stock and it has been accounted for under the "pooling of interests" concept.

Accounting Research Bulletin No. 48 differentiates between two types of combination, the first designated as a purchase and the second as a pooling of interests. The Bulletin describes a purchase as a business combination of two or more corporations in which an important part of the ownership interests in the acquired corporation or corporations is eliminated or in which other factors requisite to a pooling of interests are not present. In the case of a purchase, the acquired assets are recorded on the books of the acquiring company at the market value of the assets used as consideration for the purchase. In a pooling, the carrying amounts of the assets, as well as the earned surplus or deficit of the constituent companies, are simply carried forward to the continuing company.

Accounting Research Bulletin No. 40, in September 1950, provided four tests to be used in deciding whether an acquisition was a pooling. These tests were:

1. A continuity of substantially the same proportionate equity interests;
2. Relative size;
3. Continuity of management; and
4. Similar or complementary activities.

In January 1957, Accounting Research Bulletin No. 48 omitted the test of "similar or complementary activities." This permitted acquisitions motivated primarily for diversification to be treated logically as poolings. This Bulletin continued to fuss about continuity of interest and continuity of management, but decided that one of the constituent corporations was not "clearly dominant" unless it obtained 90 per cent to 95 per cent or more of the voting interest in the combined enterprise. Otherwise, relative size of the constituents might not necessarily be determinative. In other words, a constituent company whose equity would be only 5 per cent to 10 per cent of the combination could be acquired under the pooling concept.

Since publication of Bulletin No. 48, transactions have been held to be poolings down to as low as one per cent to two per cent of the total equity of the combination, particularly under the grouping concept, wherein a group of individual transactions taking place or planned to take place within a reasonable time could, as a group, be deemed to be an appropriate size. Exactly how an important continuity of interest in management in a one per cent to two per cent held combination could be deemed to continue in any significant way seems to the writer to be ivory-tower thinking.

In other words, our public accounting brethren continue to be harassed by their own research bulletins. They recognize that in stock acquisitions unrealistic "goodwill" situations often may develop when "valuation" is dependent on the vagaries of a fluctuating market. As a result of this, the goodwill involved can vary widely over a short period of time, depending solely on the timing of a transaction.

Criticizing the business combinations bulletin, George O. May said some time ago:

"The problem which the profession now faces resembles in some respect that which embarrassed accountants 60 years ago when the great era of consolidations began. "A legal device sanctioned the recording of the cost of the assets acquired at the face value of the capital stock plus the fair value of any other consideration given therefor. This resulted not only in inflated book values but also in a lack of a basis for proper depreciation charges."

Extension of the pooling interests notion which avoids the whimsical goodwill concept seems to me to be a step in the logical direction. In treating an acquisition as a purchase, various amounts of goodwill may be created. *Does this mean that if a corporation's stock goes off a point tomorrow, the goodwill should be adjusted?* Obviously not. *Why, once created, should it be periodically written off on a regularly scheduled basis?* If the basis acquisition was sound, a successful merger will appreciate and continue to appreciate any goodwill that may exist—not depreciate it—and goodwill should be written off only when the circumstances creating it no longer exist or are significantly lessened.

As responsible corporate financial officers, we could minimize our problems of financial presentation by three simple concepts: (1) If the acquisition is substantially for cash, treat it as a purchase; (2) if the acquisition is substantially for stock, treat it as a pooling; and (3) if goodwill arises from a purchase, write it off or adjust it only when good judgment or some identifiable circumstance indicates that an adjustment is, in fact, in order.

The pooling of interests concept permits us simply to cross-add the balance sheet of the merged companies. Conservatively it permits a balance sheet without inflation from any whimsical or artificial goodwill thinking. At the same time, the earnings-per-share curve indicates what

ANNOUNCING THE MERGER

In part of a recent questionnaire, the New York Stock Exchange was asked for direction and advice in the often touchy area of company public relations and press policy with respect to mergers. Taking for granted the need for "immediate" release of the news, the question *How immediate is "immediate"?* arose. The Exchange defined it as meaning that a company officer should leave the directors' meeting at which the merger is approved and telephone the news to the press.

In announcing a merger, how can a company make the news known to employes before they read it in the press? According to the Exchange, "Some companies have solved this problem by scheduling an employe meeting coincident with the distribution of their news release. Written announcements are often prepared for employes. Key people in plant locations are briefed in advance, of course, with appropriate security measures observed."

management is doing with its assets. Let us not complicate our reporting by unnecessary artificialities.

PSYCHOLOGICAL ASPECTS OF MERGER

In any combination, one company must be dominant—must be the acquirer, and the other company must seem to be in a subordinate position.

Perhaps the acquirer has been through several mergers. If so, its management knows that full value is realized from the combination only if proper respect is paid to the talents and capabilities which already exist within the corporation to be acquired. It is too easy for all-knowing hordes of accountants, lawyers, and operating people to descend on the acquiree before and after the actual acquisition. They are generally well-meaning but move in sometimes with an inflated idea of their relative importance and sometimes with an overzealousness to extend the realm of their personal empires.

At best, the minds of many in the acquired corporation must be uneasy—they are going through their first merger, their security is threatened, and their personal future is uncertain. And yet, this should not be so. If the merger is good, it is good because both companies involved—that is, essentially, the people of both companies—have important group and individual talents to contribute to the combination.

Failure to recognize this on the part of the acquirer may create a situation that can block a sound and logical merger or, if the merger has been accomplished, can dissipate the talents and assets of the acquired corporation, so that instead of plus values being added, something less than full value is realized from the combination and our two plus two may equal considerably less than four.

This is extremely important to controllers because very often, once the initial willingness to get together has been achieved by operating management, the first broad contacts are made in the financial areas. Overzealousness on the part of the acquirer's auditors, accountants, and tax experts; their second-guessing of operating management; needless chatter about the advantages of removing duplicate overhead—these are not calculated to get the merger off on the right foot.

The advantages of merger are, essentially, time, a broader base, greater financial strength, new products, new outlets, more rapid income growth, slower cost growth. Let us go slow on any precipitous elimination of overhead. *Who is to say who or what is unnecessary overhead, particularly in the early stages of merger?* We may find exceptional legal and accounting muscle in the acquired corporation, and a calculated program of autonomy will protect its morale, its talents, and its assets. Time will gradually bring the two companies closer together in all phases of operation, and sound management will take care of any excess overhead in due time.

Generally it can be said that the complete merger takes two or three years at least and that the eventual cost of precipitous action early in the game can far outweigh the advantage of any early overhead savings. Autonomy in operation protects and encourages the profit motive in each division of the corporation, and gradual merger permits natural strengths to fill in the vacuums created by the more rapid growth of the combination.

In addition it is, of course, of considerable importance to ensure that steps are taken to inform and reassure the personnel of the acquired corporation as to the part they will be expected to play in its future activities. They should not be left with feelings of apprehension and uncertainty. The acquired corporation was made attractive to the acquirer, in large part, because of the hard work, skills, and loyalties of its management and employes.

SKILLFUL MERGERS NEEDED

And so the merger route is not simple to navigate. It involves advanced technological, marketing, manufacturing, financial, and legal concepts—but most importantly it involves people, and it cannot be approached carelessly with any hope that economic good can result.

Merger has provided industry with a device for providing an economic service to the nation. It has provided possibilities of growth formerly unheard of and has permitted the development of technological and economic forces capable of competing in our space age.

America needs all the strength that we can create and retain in the world struggle that lies ahead. If hard work and good judgment in our concentrated efforts to combine merger with internal growth can make two and two equal five, we will have made a major contribution to the growth and security of our nation.

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merger
an art and a science

PART II

The Place of Scientific Techniques in Mergers and Acquisitions

IN CONSIDERING a merger or acquisition, management faces one of its most difficult decisions. There is much potential risk involved because of the long-term implications of such a move. An ill-advised acquisition can be the turning point in a company's history—from profit to loss, from prestige to failure. On the other hand, a carefully planned acquisition can lead to success for both parties, open entirely new product areas, and provide a basis for a good profit and for healthy growth opportunities.

In recent years, many companies have chosen the acquisition route for expansion and have been faced with the difficult decision of selecting a company or companies with which to merge. Naturally, many different methods are used for determining the best candidate for acquisition. However, such planning generally includes a great deal of detailed analysis. Volumes of information may be gathered concerning the prospect's plant, its personnel, its products, and many other aspects of its profit potential. All available financial data are usually gathered and interpreted. This analysis often must be carried out under considerable secrecy, particularly in the event that competitors are interested in the same companies.

However, when the decisions are finally made, frequently they seem to be based largely on politics or on "feelings" about certain companies, rather than on sound, logical considerations. The detailed analysis may not be used adequately in the final decision at the board of directors level because of the natural difficulty of digesting the volume of paper and untangling the many interlaced decision elements in relatively infrequent and brief board meetings.

A certain amount of initial screening of merger candidates can be accom-

plished quite readily once basic guidelines have been established. Some companies which are obviously unsuitable can be immediately discarded without further consideration. There normally remains a residue of three or four almost equivalent companies, some strong in one desirable aspect and weak in others, and vice versa. Accordingly, the difficult problem of weighing and balancing the different factors to make the best decision is created.

Although the comparison of companies according to these factors can be done intuitively through the exercise of judgment based on experience, the greater the number of factors involved, the more confusing the situation becomes. As the confusion increases, the possibility of a serious error and an unprofitable acquisition also increases.

Scientific techniques can be applied to assist in the evaluation of these factors just as they have been applied to more specific management problems such as inventory management and production scheduling. By providing a structure for the decision and a quantitative view of the intangible factors involved, the application of the scientific method can aid management in better making this critical decision.

To show how scientific methods can be applied, let us consider a typical acquisition decision problem. We will assume that the typical voluminous staff analyses have been made. Many different prospects have been investigated in great detail, and the "easy" eliminations have been made. Three companies, which we shall call A, B, and C, remain as top prospects. All three of the companies are eligible, and any one of them would be acceptable for a merger. The usual evaluations have been made, but it is still difficult to choose among the three companies, or to establish priorities for approaching them. In the following sections we will explore an approach to the solution of this problem.

DEFINING OBJECTIVES

The most important requirement of any major decision of a company, and hence of an acquisition, is that it satisfy the objectives of the company. While many companies get along rather well without ever expressing explicitly their objectives, it is certainly helpful if these objectives are expressed in writing. In most cases this much can be accomplished without much help from science. However, it would be even more helpful in many instances in reaching the most effective over-all decision if the relative importance of each of these objectives were also known. It is highly probable, for example, that each prospective acquisition satisfies all the objectives to some extent. The next step is to rank and weight the objectives, if possible.

If the company executives have never bothered with a formal definition of objectives at all, this process can be quite revealing and will be a valuable exercise to perform. It is a basic prerequisite of any intelligent planning process. The determination of relative importance can be made in a number of ways, but perhaps can best be illustrated in the context of a group meeting of key executives, such as the board of directors. Here the executives are asked to rank the given objectives and compare them in various ways.

Suppose, for example, that a vote were taken to start this process and it was established that the most important objectives were the following, listed in order of importance:

0_1—Growth rate of at least 15 per cent of sales annually
0_2—Ability to return at least 20 per cent on investment (before taxes)
0_3—Continual improvement of management personnel
0_4—Stable union relations (no major strikes, minimum turnover)
0_5—Maintenance of high standards of product quality

In the mathematical evaluation which follows, we assume that the objectives are mutually exclusive, that is, attainable independently of each other, and that the values of these objectives are additive.

It is highly probable that each executive will have a different opinion of the relative importance of these objectives. Following is a method for obtaining the best consensus of the relative values of each of these objectives.

WEIGHTING OBJECTIVES

Each objective must be numerically weighted in order to quantify the various opinions about their relative importance and to use them in further evaluations. One method which can be used to weight the objectives is the "Relative Theory of Value" which was introduced by Professors Churchman and Ackoff in the May 1954 issue of the *Journal of the Operations Research Society of America.* In general, this method consists of assigning tentative relative values to each alternative, testing these values by successive combinations of the various alternatives, reviewing all values for logical consistency and normalizing the results. The evaluation can be accomplished fairly efficiently in a group meeting by independent voting, accompanied by free discussion among the participants. An arbitrary scale of values, such as 0 to 10 as is used in our example, must first be established. Or perhaps more easily, each member of the group can note his own evaluation of each objective, and averages can be taken to obtain initial values of the objectives.

The remaining steps in the process can be illustrated as follows:[1]

1. The most important objective according to the original ranking (0_1) should be given the highest value (in this case, 10 unless the average method is used). Each of the other objectives should be given a tentative value in relation to the most important one. For example:

[1] In this process it is easiest to think of executives carrying out the process one by one, although group action has a great deal to offer provided a strong, experienced moderator is available to assure progress.

ABOUT THE AUTHOR

• ROGER R. CRANE *has degrees from the Massachusetts Institute of Technology and the University of Toronto and has done research with a number of universities. He served as an officer in the United States Navy during World War II and subsequently worked at the Naval Research Laboratory and the Operations Evaluation Group of the U.S. Navy. In 1952, Mr. Crane joined Westinghouse Air Brake Company and became director of Operations Research there. He has been with Touche, Ross, Bailey & Smart since 1955 and is principal-in-charge of the Management Services Central Staff at the firm's New York office. Mr. Crane is a well-known author and lecturer, a past president of the Institute of Management Sciences and editor-in-chief of* Management Technology. *In the preparation of this article, Mr. Crane was assisted by* ALVIN E. WANTHAL *of his firm.*

$0_1 = 10$
$0_2 = 7$
$0_3 = 5$
$0_4 = 3$
$0_5 = 2$

2. The assigned values should first be tested by considering whether the value for 0_1 is greater than the sum of 0_2, 0_3, 0_4, and 0_5. If, for example, 0_1 is considered to be 25 per cent more valuable than the sum of the other objectives, the relative values of the others should be adjusted downward accordingly as follows:

$0_2 = 4.0$
$0_3 = 2.5$
$0_4 = 1.0$
$0_5 = 0.5$

3. Then the value assigned to 0_2 should be tested by considering whether 0_2 is more valuable than the sum of 0_3, 0_4, and 0_5. If it is 25 per cent more valuable, the other values should be adjusted as follows:

$0_3 = 1.5$
$0_4 = 1.0$
$0_5 = 0.5$

4. Next the value of 0_3 should be tested by considering its relation to the combination of 0_4 and 0_5. If the values should be about equal, as they are, the valuation is correct.

5. All values should then be rechecked for consistency with the original evaluation. If the two are inconsistent, an error in logic has been made, and the entire process should be repeated beginning with the original ranking. In our example, this comparison is as follows:

Original	*Final*
$0_1 = 10$	$0_1 = 10$
$0_2 = 7$	$0_2 = 4$
$0_3 = 5$	$0_3 = 1.5$
$0_4 = 3$	$0_4 = 1.0$
$0_5 = 2$	$0_5 = 0.5$

6. Since both evaluations are consistent and thus logically correct, the final results should be normalized by dividing by the sum of all values (17). Thus:

$0_1 = .59$
$0_2 = .23$
$0_3 = .09$
$0_4 = .06$
$0_5 = .03$

By this sequential evaluation process, each objective of the company has been given a relative value based on the combined judgment of the management personnel. These values can now be applied to the prospective acquisitions.

MATCHING ACQUISITIONS AGAINST OBJECTIVES

To determine the extent of which each prospective acquisition satisfies the company's objectives, scientific techniques can again be employed to quantify the judgment of management and clarify the decision problem. The purpose of matching acquisitions and objectives is to determine the over-all value which might be expected from each prospective acquisition, considering it in relation to each of the major objectives. This comparison can be facilitated by the use of a mathematical model. The model can be filled in by placing a value in each box which represents the extent to which each acquisition satisfies each objective.

The interpretation of these values must be established before they are determined. An arbitrary scale of values must first be established such as the —10 to 10 which we chose. In our illustration, —10 indicates that the acquisition seriously threatens the objective, 0 indicates that the acquisition has no effect on the attainment of the objective, and +10 indicates that the acquisition virtually guarantees the objective.

To demonstrate how a particular value was chosen, consider Company A and Objective 0_2. Company A is a large company with poor management personnel. It would be very unlikely that our company would be able to secure a 20 per cent return before taxes by acquiring Company A because of the size of the investment required and the associated shortcomings of the personnel. Therefore, this alternative was given the value —9. The logic behind the other values is similar in nature. The completed model with all values is shown in *Exhibit I*.

Again, the values can be established by independent voting of the executives and discussion of the resulting rows and columns, or they can be individually established and the results averaged. The expected value can be calculated for any particular acquisition by multiplying the value in each box of that row by the normalized value associated with the corresponding objective, and taking the sum of the five products. For example, the expected value of Company B is: $7(.59) + 2(.23) + 0(.09) + 4(.06) + 6(.03)$, or 5.01.

MATCHING PROSPECTIVE ACQUISITIONS AGAINST POSSIBLE CONDITIONS

One of the most important risk factors which should be considered is the consequence of making the acquisition under various possible conditions of the market. In order to evaluate this factor, it is necessary to prepare some quantitative data concerning the probabilities that certain future events will occur. The use of probability is not so complicated as it sounds. In fact, once the concept is understood, the application is fairly simple and the results will contribute significantly to the structure of the basic decision problem.

The most significant characteristics of the acquisitions should first be identified, to serve as guides for thinking

EXHIBIT I

Five-year Corporate Objectives	0_1 15% Annual Growth	0_2 20% Return Before Taxes	0_3 Better Management	0_4 Good Labor Relations	0_5 High Quality Product	Expected Values If Acquired
Associated Value	.59	.23	.09	.06	.03	
Description of Prospective Acquisition						
A Large Company Poor Management	8	—9	—6	—4	4	1.99
B Medium Company Good Management	7	2	0	4	6	5.01
C Small Company Excellent Management	5	7	8	9	7	6.03

about the effect of future events. These characteristics might include the size of the company facilities, the quality of the management personnel, or other similar factors.

The market (or markets, in the case of a diversified company) must be identified and analyzed to forecast the probable future behavior. The market for the entire company's product (including the acquisition) should be considered, and it should be determined if the acquired company's product will be similar or identical to the parent company's product. If there is a diversification motive involved, the market for both companies' product lines must be considered when assigning values within the model. Therefore, the diversification model would be similarly constructed but more complicated than the single product model. It is assumed that normal market research techniques will be (or have been) used to develop information on these product markets.

A probability of occurrence can be attached to different market conditions by observing past trends. However, this should be adjusted for the future outlook if significant changes are predicted. To estimate this probability, consider the sales trend at any point in time and the outlook for a future period (perhaps, one to three months). Then note the behavior at the end of the period as one occurrence in a frequency distribution: By considering successive points on the same time axis in this manner, the complete frequency distribution can be obtained, from which the reasonable range of possible conditions can be determined. These probabilities must add up to 1.0, because they should cover the entire range of possible alternatives.

After estimating the probability of any possible future market condition, the initial comparison of acquisitions and conditions can be made. However, this comparison can be improved significantly if the probability of making any prospective acquisition is also determined.

To estimate this probability, we must consider the peculiar situation of each prospective acquisition individually. The following factors should be evaluated: The attitude of the prospect's executives toward mergers in general and toward our company in particular; the financial condition of the prospect, with all associated factors; the potential competition for the prospect as a merger candidate; and the nature of the bid which we intend to make for the prospect (financial or political limitations). Thus, the probability of acquiring each prospect will be determined mainly by judgment of our management personnel who are making the decision, but this is a judgment which can be isolated and made fairly easily, within reasonable limitations. These probabilities should fall within the range of 0 to 1.0, with 0 representing no possibility of acquiring, 1.0 representing certain acquisition, and 0.5 representing a "tossup" situation.

All these probabilities, factor analyses, and market studies can now be employed and considered in a model of the combined company situation relative to various market conditions. This model can be constructed as shown in *Exhibit II*.

Although our model is shown with values already included, the matrix should originally be furnished to the executives in its blank form with only the alternatives and probabilities noted. The values should then be filled in by a group discussion process. The arbitrary scale which we chose for the values ranged from —10 to +10. Each value should be determined by considering the question: *If we acquired Company Y, what is its value if the market does X?*

To illustrate how a typical value was determined, consider Company A relative to an increase in the market of 10 per cent or more. This acquisition would be particularly desirable in such a situation because of its capacity, but the shortcomings of its management personnel reduce the potential value from the maximum attainable. Therefore, this combination was given the value +7. The values for the other combinations were determined in a similar fashion.

After all values have been assigned, the expected value of acquiring each company relative to the probable market conditions can be evaluated. This evaluation can be made by summing for each company the product of each market condition and the value associated with it. For example, the expected value of Company B is:

$$0.1(-2) + 0.3(5) + 0.6(6) = 4.9$$

The conclusion that can be drawn from these values is that Company C would be the best acquisition, considering the market behavior only.

The expected values can be adjusted to consider both the probable outcome of the acquisition attempt and the market trend. The calculation is elementary; the product of the previously calculated expected value should be multiplied by the probability of acquiring each company. The effect of this calculation is to include a consideration of both factors in the new values. In our example, the calculation results in Company B, rather than Company C, being considered the best candidate for the acquisition attempt. *(Continued on page 340)*

EXHIBIT II

Possible Market Conditions / Probability of Occurring / Prospective Company Acquired (Significant Factors) / Probability of Acquiring	Drop 10% or More 0.1	±10% of Present 0.3	Increase 10% or More 0.6	Expected Value of Each Acquisition Considering Market Only	Expected Value of Each Acquisition Considering Market and Probability of Acquiring
Company A Large Plant Poor Management 0.5	—10	2	7	3.8	1.9
Company B Medium Plant Good Management 0.8	—2	5	6	4.9	3.9
Company C Small Plant Excellent Management 0.5	3	6	6	5.8	2.9

Ronello B. Lewis *tells how to set up your own operating results monthly to reveal new downtrends or weaknesses in need of corrective action*

Red-Flagging Trouble Spots

THE "RED-FLAGGING" TECHNIQUE is an easy device used to speed up communication. It makes reports easier to read. It focuses attention on weak spots quickly. It brings the impact of the printed page to the attention of the reader in a matter of seconds. It establishes ratio and proportion. It gives emphasis where emphasis is due. By providing easier understanding, it also brings about a faster meeting of the minds. The cause is pinpointed more readily. And the basis for corrective action is suggested. Thus, a chain of actions is stimulated. The result is better profits.

Strictly speaking, a red flag is defined as any division, department, segment or part of the business where earnings for the month or the period to date are below the budget or below the previous year. It is revealed through the use of the so-called "better-or-worse" comparisons in which all performances below budget or below last year are highlighted in red, and this is done both dollarwise and percentagewise. An illustration of such an approach accompanies this article.

Profits depend on timing. And timing means taking action early rather than late. Early action stems from early decision, and early decision stems from knowing the facts in time. But the pertinent facts are not alone those that tell whether a thing is good or bad. Instead, it is perhaps more vital to know the trend—that is, whether a thing is getting better or worse. Such a trend can be revealed by making timely comparisons of sales and earnings monthly against a common base—usually budget, last year, or both—and by highlighting the unfavorable variances in red. Thus, the expression "red flag" is true both literally and figuratively. Yes, unsatisfactory deviations from budget, or last year, are reported in amount and percentage in the better-or-worse columns, and these columns become an integral part of the top summary operating reports of the company.

True, the red flag does not give the final answer. But it points the way. Running a business profitably is an interesting game in which efforts are heightened in a spirit of competition. The red-flagging device supports such an effort and provides much of the spirit through which it is maintained. A catchy phrase is coined. A door-opener is provided. And a basis for easy communication between top and middle management has been introduced.

These are intangible advantages but they have practical value in providing a wholesome climate for greater effort and understanding.

ABOUT THE AUTHOR

• MR. LEWIS, *a member of Controllers Institute of America, is a consultant to industry with offices at Greenwich, Conn. He is author of three books published by Prentice Hall, Inc.*—Accounting Reports for Management, 1957; Financial Analysis for Management, 1959 *and* Profit Planning for Management, 1960.

STEP 1 Enter title

Make it short. Show just enough. No more. No less. For example—sales and earnings for November 1960.

STEP 2 Enter column headings

The first column is invariably the actual results for the period. The second column should show the budget, if there is one. If not, show last year. The remaining two columns are for showing comparisons, both in dollars or percentages, of actual results against the budget or last year.

STEP 3 Enter particulars

Divide the particulars into two parts. Show sales in the top part and earnings in the bottom part. Then break sales down into four to six principal parts or segments—like Departments A, B, C, and D as shown. Break pretax profits down into similar parts, and show a subtotal. Subtract any unallocated or general expenses. Then show lines for total profit before taxes and per cent to total sales. Subtract federal taxes, which are measured as a ratio to pretax profit, and enter net profit. Show preferred dividends, and subtract to determine balance of earnings for the common shareholders. Divide by number of shares outstanding, and enter earnings per common share.

STEP 4 Actual sales

Enter actual sales for the period. For example, Department A's $25,000 plus B's $25,000 plus C's $20,000 plus D's $27,500 add to the total of $97,500.

STEP 5 Budget sales

Enter budget sales, or last year sales, as the case may be. For example A, B, C, and D are entered at $20,000; $25,000; $25,000; and $30,000 respectively. These are footed to the total of $100,000.

STEP 6 Better or worse

Enter the amount that actual sales are better or worse than budget or last year, depending on the comparison used. For example, A's sales are $5000 above budget, B's are a breakeven, C's are $5000 below budget, and D's are $2500 below budget. The total is down $2500 from budget. The last three of the figures just mentioned are entered in red to denote worse.

STEP 7 Per cent better or worse

Divide step six by step five and enter per cent better or worse. Show to one point after the decimal.

STEP 8 Actual profits

The illustration shows the proper sequence. For example, pretax profits are entered—A has $2250, B is $2250, C $2000 and D $2400. This makes a total of $8900 from which general expenses of $1100 are subtracted, leaving a profit before taxes of $7800. This amount is divided by total sales to show a ratio of 8.0 per cent and federal taxes of $3900,

(Continued on page 332)

WORKSHEET

TITLE	STEP 1	SALES AND EARNINGS FOR NOVEMBER 1960

COLUMNS	STEP 2	ACTUAL	BUDGET	BETTER OR WORSE

PARTICULARS	DOLLARS	DOLLARS	DOLLARS	%
STEP 3	STEP 4	STEP 5	STEP 6	STEP 7
SALES				
Department A	25,000	20,000	5,000	25.0
Department B	25,000	25,000	—	—
Department C	20,000	25,000	5,000	20.0
Department D	27,500	30,000	2,500	8.3
TOTAL SALES	97,500	100,000	2,500	2.5

PROFIT	STEP 8	STEP 9	STEP 10	STEP 11
Department A	2,250	2,000	250	12.5
Department B	2,250	2,500	250	10.0
Department C	2,000	2,500	500	20.0
Department D	2,400	3,000	600	20.0
SUBTOTAL	8,900	10,000	1,100	11.0
Less general expense	1,100	1,000	100	10.0
TOTAL BEFORE TAXES	7,800	9,000	1,200	13.3
% to total sales	8.0%	9.0%	xxx	xxx
LESS FEDERAL TAXES	3,900	4,500	600	13.3
% to pretax profit	50%	50%	xxx	xxx
NET PROFIT	3,900	4,500	600	13.3
Less preferred dividends	500	500	—	—
BALANCE TO COMMON	3,400	4,000	600	15.0
Number of shares	20,000	20,000	—	—
EARNINGS PER SHARE	17¢	20¢	3¢	15.0

ANOTHER WAY TO BRIGHTEN THE PROFIT PICTURE?

When all, or nearly all, the "trouble spots" have been red-flagged and corrected; when all the well-known tools of financial management—cost accounting, budgeting, auditing, and financial reporting—have been sharpened and refined; there remains one avenue to profit improvement which the financial executive may have just begun to fully explore. This, according to *Management News,* involves the proper internal management of cash.

One of the first requisites for a cash management program is the development of an analysis of all items affecting the cash flow, reported the American Management Association magazine in its April issue. When this is done, a pattern will emerge reflecting cash excesses and deficiencies, and policy and procedure changes to improve cash utilization may be worked out. The company will frequently find it possible to accelerate cash receipts and improve the timing of disbursements. It will then be in a position to reap its full share of the rewards of investing its cash, in excess of equitable and reasonable bank deposit levels, in short-term securities.

or 50 per cent of earnings, are subtracted. The remaining net profit is entered at $3900. After subtracting preferred dividends at a monthly rate of $500, this leaves $3400 for the 20,000 common shares outstanding, or an average profit of 17 per cent per common share.

STEP 9 Enter budgeted profits

Repeat the above steps for the budget, or last year, as the case may be.

STEP 10 Show better or worse

Compare steps eight and nine. Where actual results are better than budget, or last year, show the difference in black. Where actual results are worse, show the difference in red. Foot and prove.

STEP 11 Enter per cent better or worse

Divide step ten by step nine and enter per cent better or worse.

The accompanying report shows only two favorable comparisons. One is Department A where sales and profits are above the budget. The other is federal taxes which are down $600 from budget. But, this is small consolation, since the reduction stems from smaller earnings. Four other instances are red flagged for immediate attention and—let us hope—prompt corrective action. These are:

1. Department B where earnings are down 10 per cent;
2. Department C where sales and earnings are off 20 per cent;
3. Department D where earnings are down 20 per cent with a reduction of 8.3 per cent in sales; and
4. General expenses, up 10 per cent despite the over-all decline in sales.

This is an important message. But more important than the message itself is the impact with which it is delivered. As an easy means of communication, the worksheet or report accompanying this article contains a dozen or more unique features. Eye appeal and easy reading are thus enhanced. For example, note that the report follows organization lines, giving strong emphasis to actual-versus-budget comparisons and significant ratios. The title is short, the column headings are easy and the particulars follow a logical sequence. The report contains several parts or sections, and these appear in boxes, separated by gutters. Other aids to reading are found in the lateral and vertical guide lines, in the alternate use of upper and lower case type and in the spacing of particulars to provide relative emphasis and quick orientation for the busy executive to whom the report is directed. The so-called better-or-worse treatment is a handy device used in highlighting weak spots, providing reporting in red of all segments that show up worse than the budget, or last year. Thus, attention is directed quickly to the exceptions that are most in need of review. In this way, the business is given more than a mere conversation piece. It is given a basis for action. As a result, new downtrends are revealed in their earliest stages, and correction is made before too much damage is done.

Enlightened business is recognizing the need for clarity in reporting as a basis for getting things done. The report illustrated here is only the top sheet in a possible series of reports. As such, it might be called by several names such as "flash report" or "red-flag report" and so on. Time is of the essence in the use of all flash or flag figures of this kind. In most cases, a sheet such as this would be issued by the fifth calendar day, covering the month preceding. And this would be followed quickly by the issuance of supporting sheets, in a similar format, showing the underlying detail. Such a trend toward speed and clarity in reporting is doing much to assist those who are responsible for profits in the business enterprise.

SIXTEEN WAYS TO MAKE YOUR REPORTS EASIER TO READ

Follow organization lines	Use upper and lower case
Show budget comparisons	Show "better-or-worse"
Report significant ratios	Make it add down
Use short headings and titles	Make it check across
Select easy column headings	Report in round dollars
Use uniform particulars	Use color
Use guide lines	Use uniform paper
Divide the report into boxes	Emphasize important elements

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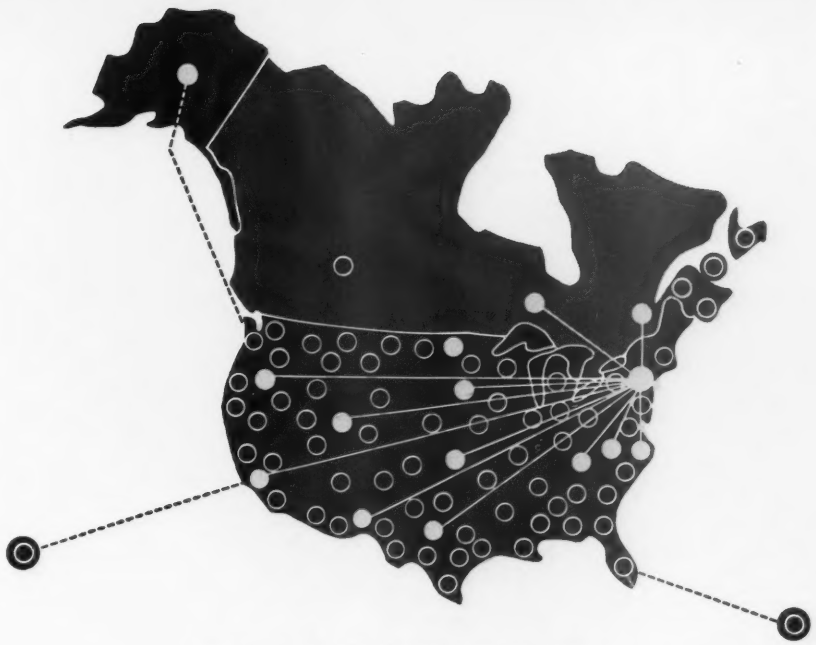
PROBLEM:

to process away-from-home claims
for 83 Blue Cross Programs



SOLUTION:

a Western Union Private Wire System

Health insurance has become as widespread as the Blue Cross insignia . . . with 56,000,000 people in the United States, Canada, and Puerto Rico insured by 83 participating plans. Because Blue Cross protection travels with subscribers everywhere, a serious communications problem arose for this fast-growing organization: *How to process out-of-area claims with all possible accuracy and speed.*

A Western Union Private Wire System was the answer. Now—to process 23,000 claims daily—46,000 written messages travel over 22,000 miles of wire. Claim "okays" that formerly took hours now take minutes.

Through the work-saving advantages of this Western Union Private Wire System, Blue Cross Headquarters estimates savings of $975,000 a year on claim-processing alone.

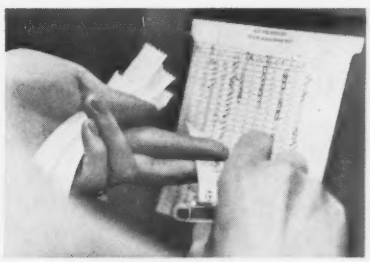
So useful has this system proved for all inter-Plan communications that capacity was raised recently to 216,000 words per day. That's an increase of almost 500% over 1959.

Couldn't your company—like Blue Cross—save both time and money and provide better service with a Western Union Private Wire System? It will be a system *specifically designed* for your company's communications needs.

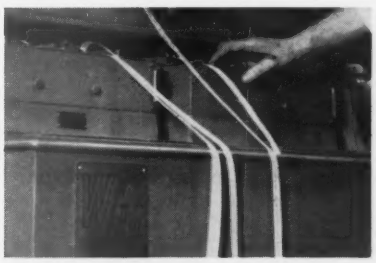
For all the facts, without obligation, wire collect to: Western Union, Private Wire Division, New York, N. Y.

How Blue Cross claims can be serviced from 50 states, Canada and Puerto Rico

10:52 A.M. Request for claim information is sent over a high-speed Duplex System, which permits simultaneous sending and receiving, from any of 107 offices.



10:54 A.M. Received at Blue Cross Private Wire "Braincenter" in New York City, message is instantly forwarded to member-plan covering patient.



10:59 A.M. Wire reply comes back to "Braincenter" from local Blue Cross plan on perforated tape, and is then immediately relayed to the originating hospital.

WESTERN UNION... first in Private Wire Systems

X.UM

READING FOR THE FINANCIAL EXECUTIVE

Electronic Data Processing and Auditing*

By Felix Kaufman

Dr. Kaufman has exerted much effort to record, in a well-connected fashion, the many links that make up the computer chain from data input to document output. He has quite skillfully described the control features in an understandable manner. The author has long felt the need for a manual that would be concerned primarily with the control aspects of data processing.

The title indicates that the book is pointed toward the public or internal auditors. Notwithstanding, anyone interested in acquiring "know-how" concerning this new neighbor who lives next door and is fast becoming a permanent part of our lives, will gain from this book. However, the book is of little value to the computer sophisticate.

Our author assumes that his reader has a reasonable understanding of punched cards or other input media. For the uninitiated, punched cards represent the most common input medium to magnetic tape, except in such specialized applications as banking and retail operations. For example: One aviation company, with a large computer installation, transcribes about 95 per cent of its data from source records to punched cards prior to incorporation on magnetic tape.

Dr. Kaufman starts his story with this statement: ". . . Control-conscious individuals are bothered, or at least perplexed, because electronic data processing may have such a profound effect on the external aspect of the paper-work world. . . . The effect of electronic data processing on internal control is, perhaps, the most important topic in this work."

So as to clearly indicate the extent of Dr. Kaufman's research for this book, the reviewer will not restrict these comments to his opinion, but will include a synopsis of the author's story.

Now the story unfolds. We learn about the general terminology of computers. This chapter is not a glossary of technical terms used by the programmer, but an interesting description of the general terms we all need to know in order to have some understanding of computers; such as: programming, record, file, transaction, updating, hardware, on-line, off-line, storage, access, tape system. This description is followed by an explanation of such terms as: peripheral operations, processing, arithmetic, control, matching, copying the files.

Next we learn about the planning necessary for a successful installation, which should incorporate a complete statement of the procedure including all exceptions in language understandable to the auditor and to the nontechnical person; process, computer and program flow charts; automatic programming; controlling programs; console control.

When we have assimilated this general background (this is done in a nontechnical fashion), we are ready to examine the following general areas of application: payroll, sales, accounts receivable, cash receipts, purchases, and cash disbursements. In each case, a chart reproduces the activities and operations as described in the 1949 pamphlet published by the American Institute of Certified Public Accountants and associates with these a representation of the data flow in the EDP system which crosses departmental lines. The charts are augmented by outlines of the capability of the computer to integrate the entire function as a single operation. This principle is sometimes called the "total systems concept."

The applications, as outlined by the author, are quite comprehensive and deserve mention here.

In the *payroll application,* the program would include: maintenance of payroll files, preparation of checks, timekeeping, reconciling dual reports, labor distribution, personnel files.

REVIEWED BY

DAVID R. DOWNING

formerly a division comptroller of Allied Chemical Corporation, New York, and now director of computer applications. He is a member of Controllers Institute.

In the *sales application,* the program would include: editing of incoming orders, credit review, recordkeeping prior to issuance of invoice, inventory control, sales analysis.

In the *accounts receivable application,* the program would include: invoice processing, credit, statement preparation, special debits and credits. Cash receipts would become a part of this program.

In the *purchase application,* the program would include: the status of open orders, vendor performance, inventory control with replenishment advice, request for quotation, purchase order, commitments, follow-up, receipt of material, approval of vendor's invoice, accounts payable, expense distribution, budget comparison, issuance of check. Cash disbursements and check reconciliation procedure would become a part of this program.

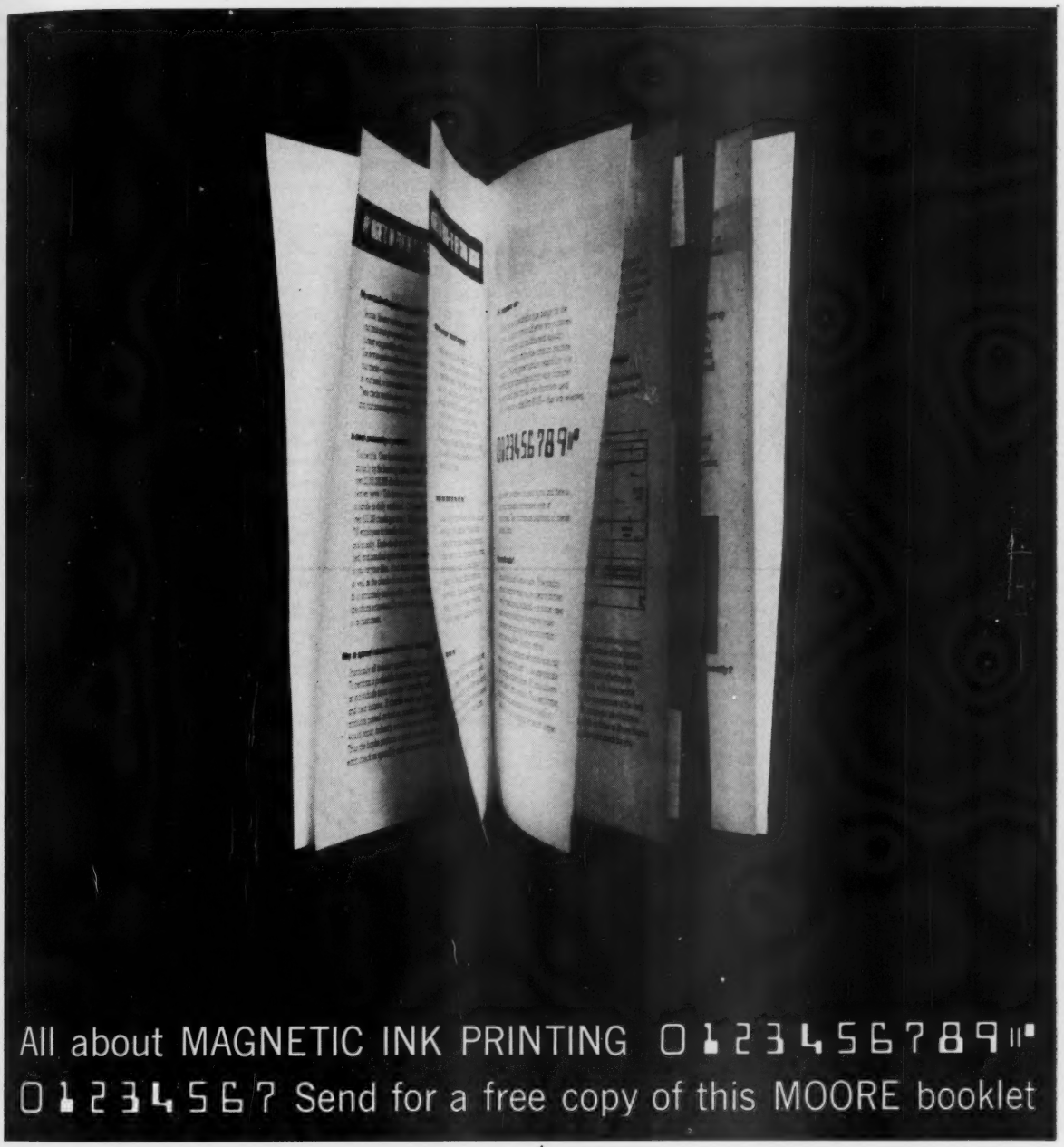
The foregoing chapters on applications definitely indicate the possibilities to one of foresight and patience, and should be the goal of anyone installing a computer. However, the author does not emphasize the magnitude of the task. (There will be many times when you will wish to trade positions with the receptionist.)

Now that we have acquired some understanding of computers and their possibilities as to applications, we are ready to consider their reliability. The natural reliability of digital computer circuits is of the highest order. This reliability is the result of several factors and is illustrated quite clearly by the author. For example: many electrical devices operate over a range of conditions, but a computer component is like a light switch. It is generally operative or inoperative. This type of explanation extends to other parts of the computer complex: namely, parity checking, echo checking, dual heads in the tape unit, dual circuits, complementation.

We just mentioned natural reliability. There is also system reliability or system accuracy. Accuracy is achieved through incorporating in the program a series of instructions for specific purposes, such as catching errors. For example: product number 13452 shall be priced between 70¢ and 80¢. (Programming is the set of instructions placed in the computer by the operator to accomplish a certain job, such as preparation of customer invoices.) The author, at this point, speaks of redundancy in programming as a control feature. Redundancy in programming should not be necessary in a well-conceived program.

Dr. Kaufman's description of the accuracy that can be programmed into the electronic system is well written. A

(Continued on page 338)



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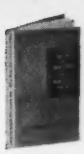

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high degree of importance should be placed on this section for the following reasons:

(a) An understanding of the accuracies of the equipment and the controls that can be programmed into these systems will give the auditors a basis for determining the degree of control incorporated into the system they are examining;
(b) Once the auditors are aware of the accuracy of this equipment, they can develop audit programs for use by both internal and independent auditors.

At this point we are ready to consider operation of the computer complex. As you know, the whole system depends upon data stored on magnetic tapes. All reasonable steps must be taken to eliminate errors in tape handling. For example: should a reel of tape containing current up-dated data be placed in an output tape station, all the current data would be erased and the data from the computer would be placed thereon in its place. Incorrect labeling of reels could create chaos. Control of all input and output records is extremely important, as it is not possible to visually examine magnetic tape as it was possible to examine punched cards.

Next we will consider internal controls which are classified by the author as follows: proof total techniques, comparison of separate source data, physical checks.

Proof total concepts should be limited to data sources outside the sphere of the computer. At times, it may be more practicable to use the batching process rather than the proof total concept. To simplify later processing of data, the editing and balancing function is usually performed before the regular computer operations. Comparison of separate source data can be made by independent parties, if properly planned. However, most of such comparisons can be accomplished by the computer, if properly programmed.

Physical checks, such as counting, can be incorporated in a computer program and used in comparison with book records.

One other phase requires attention. One should establish that the program in use was developed by authorized personnel and will do what it purports to do.

And now we consider the final chapter—the auditor and audit trail conditions. In non-EDP system, the printed or written records have generally sufficed for audit purposes. However, in magnetic tape and in random access systems, current records cannot be examined visually. To place hard copy records in the hands of the auditor may effect a hardship on the computer schedule unless the request is carefully planned. Therefore, the auditor should familiarize himself with the computer schedule.

This chapter on audit trail conditions covers, for the most part, a negative approach to the problems that now confront the auditor and that will increase as EDP becomes more sophisticated and operates principally on the exception principle. Dr. Kaufman did not attempt to explain how the independent and internal auditors could use this accurate equipment to expedite an audit. There are several operations that do not require judgment on the part of the auditors but must be performed during an examination. These functions can be processed on an electronic system. Just a few of these steps are preparation of confirmation requests, reconcilements of subsidiary ledgers, control accounts and selection of items for further examination.

The reader should find, as the reviewer did, that Dr. Kaufman's book will truly aid in the development of a better understanding of the problems in electronic data processing and in internal control.

* *Published by the Ronald Press Company, 15 East 26th Street, New York 10, N. Y. $6.00.*

MANAGERIAL STATISTICS (Second Edition)*

By Kermit O. Hanson and George J. Brabb

This book deals with sources of data and methods of analysis useful to management in planning and controlling organizational activities. In presenting the elementary techniques used in statistical research, the authors adopt a nonmathematical approach and stress only those methods which have direct, practical application to business management.

For the Second Edition, material on control charts has been expanded to show how such charts can be used in controlling time series forecasts, regression forecasts, and budget activities, and the chapters on other charts and tables have been revised and expanded to include a new section on the construction and use of ratio (semilogarithmic) charts.

* *Published by Prentice-Hall, Inc., Englewood Cliffs, N. J. $9.25.*

*DR. KAUFMAN ON THE EFFECTS OF EDP ON INTERNAL CONTROL**

> When a computing machine takes over a series of clerical steps, it appears to violate the separation principle of internal control . . . [But,] in fact, the kind of control attributed to separation is heightened by electronic data-processing machines. The explanation of this proposition follows.
>
> There are two ways to be inaccurate: deliberately and inadvertently. Deliberate errors require planning; and if the plan is executed in the presence of effective control, it also requires collusion. Computers do not plan and cannot collude. The computer *can* make inadvertent errors because of the failure of its circuits to operate properly. However, there are devices and programming methods to deal with these errors . . .
>
> *The rationale for abandoning the principle of separation here is found in the impersonal attitude of the computer.*

* From an article in the June issue of the *Journal of Accountancy.*

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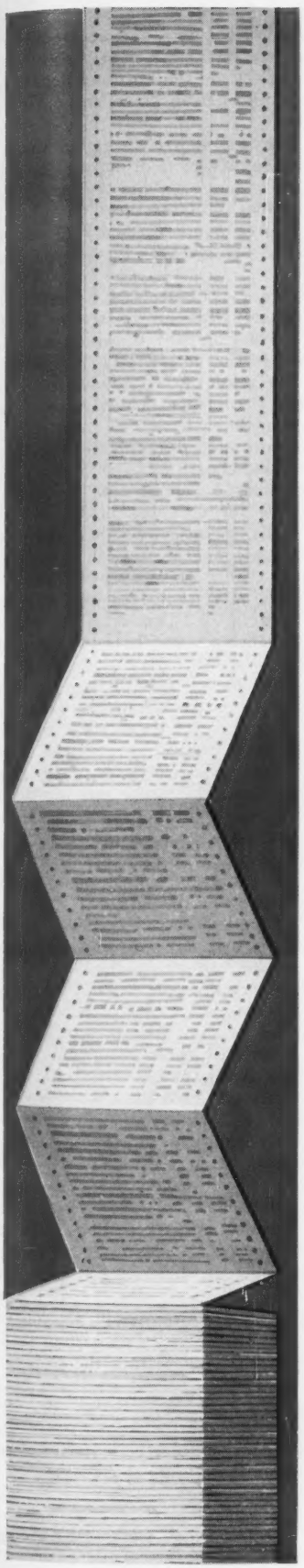

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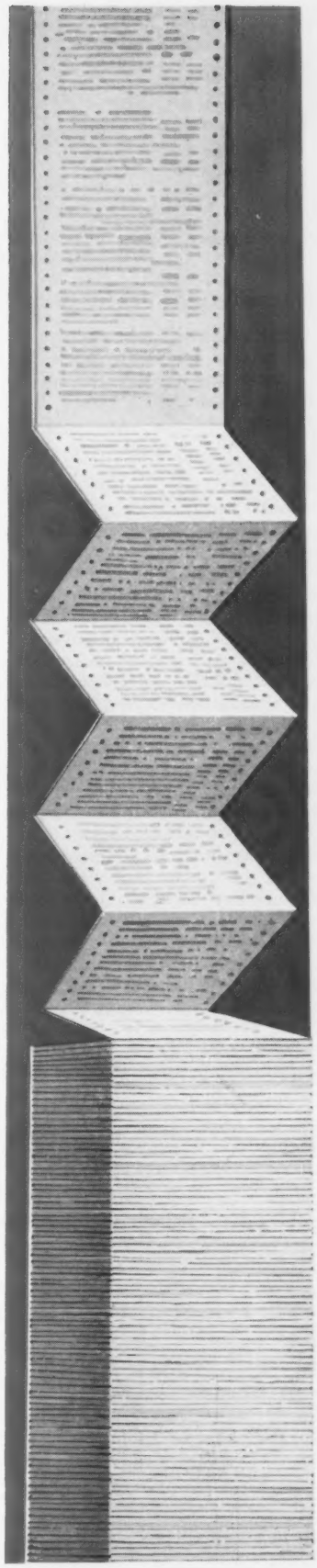


merger
an art and a science

PART II—CRANE

(Continued from page 329)

OPTIMUM ACQUISITION STRATEGY

If the acquisition desires of our company become known to a competitor, the competitor may review his own position and decide to pursue the same prospects or he and others may already be doing so, particularly in a single-product situation where certain companies are considered to be particularly desirable merger candidates. In the event that this situation occurs, mathematical techniques can again be employed to determine the optimum competitive strategy. The particular technique involved is the Theory of Games. It is applicable to any situation which involves opposing forces, each of which has an identical set of alternative moves. Analytical techniques are now available for many simple varieties of games, but unfortunately the mathematics of solving more interesting and difficult games becomes quite cumbersome as the size of the games increases.

Many business situations can be analyzed as competitive games to improve the insight of the executives involved and possibly increase the probability of a favorable outcome. By viewing a situation as a game, competitive moves can be anticipated and countered. Thus, even though game theory is still in its infancy with respect to problem-solving capability, when applied as an analytical tool, it can still contribute significantly to the outcome of important decisions.

In the previous analysis of our example, it became apparent that Companies B and C were both fairly equal as desirable candidates for merger, while Company A was eliminated from consideration. In the event that a principal competitor had reached the same conclusion, an ideal game situation would result. The conflict situation is readily apparent, consisting of two persons opposing each other with each person having the same three alternatives or moves: (C), (B), or (B and C). It might be desirable to approach either Company B or Company C individually, but once one was chosen and approached, the likelihood of getting the other would be reduced in the event that the first approach was unsuccessful. The advisability of making either one of these two choices will be evaluated in our game, together with the alternative of approaching both companies at the same time. It would be possible, of course, to test a large variety of alternatives, but from our previous analysis, these three appear to be the most interesting.

Essentially, by playing this game, we are trying to determine the best strategy to pursue in competing for the companies. For the purposes of the game, the best strategy will be the one which guarantees us the maximum pay-off over the long run. Since each player will probably only have one move in our game, the possibility of playing various moves according to the odds, which would insure our maximum long-run gain, is not available to us. However, studying the game may still be a valuable exercise.

In the normal technical terminology, this game would be called a two-person zero-sum game. One of the prerequisites of such a game is that any pay-off to one of the opponents (persons) must be at the direct expense of the other. Our objective will be to maximize our gain in terms of pay-off, while our opponent will attempt to minimize his losses. Assuming that the most favorable alternative for both persons would be to acquire both B and C, it is not difficult to understand the zero-sum definition—what one person gains, the other must lose.

The first step is to assign values to each combination of moves. To select these values, we must consider nine questions similar to this one:

If we choose Company C and they choose Company B, what is the pay-off to us?

In our example, such a move would probably allow us to realize the full value of Company C, which was calculated in the previous example as about 6. The result of our move B versus their move C could be calculated as 5 in the same manner. If we had chosen C and B with the objective of getting both and they had chosen either C or B, our pay-off might be slightly higher than the pay-off for choosing either one individually, because we would almost certainly get one acquisition and have an equal chance of bidding for the other. Accordingly, these pay-offs were each judged as 7. The diagonal pay-offs, representing the three moves where each opponent is bidding directly against the other, have been set at low values to reflect the obvious uncertainty and undesirability of such situations. The other values were placed on the arbitrary scale of 0 to 10 by similar judgments, which are not too difficult to make, particularly in real situations where more detailed knowledge of the competitor and the situation is available.

The game matrix, with all values filled in, is shown in *Exhibit III.*

To realize the full value of the game analysis, after all pay-offs have been determined, we must calculate the optimum strategy for each opponent and the theoretical value of the game. By careful examination of our game, we can see that there is no single move which is always best for either of the two players. Such a condition would be called a "saddle point" and would greatly simplify the play if it were present, because the best strategy for either player would be to always play this one move.

However, since our game is not one of these most simple cases, we conclude that the best strategy for each player will be a "mixed" strategy; i.e., to play various moves alternately, depending on the odds associated with each move. The method for calculating the odds to be used in these mixed strategies can be found in various books on Game Theory. The original development work on the theory was performed and pub-

(Continued on page 342)

EXHIBIT III

		Competitors' Moves			
		C	B	C and B	Odds (see text)
Our Moves	C	3	6	5	4
	B	5	2	4	4
	C and B	7	7	3	1
	Odds (see text)	1	0	2	

CIA NEWS

Elected as CIA Top Officers . . .

MR. CAPON

MR. YODER

MR. PERSBACKER

MR. FARRAND

The New President

ARTHUR L. BOSCHEN

ARTHUR L. BOSCHEN, vice president-finance, Richardson-Merrell Inc. (formerly Vick Chemical Co.), New York, was elected president of Controllers Institute of America by unanimous vote of that organization's board of directors. The election took place at a meeting of the board of directors on June 8, 1961 in conjunction with the Institute's 1961 Northeastern Area Conference, held at the Lake Placid Club, Lake Placid, N. Y. Mr. Boschen will serve as president for the Institute's fiscal year 1961-62, which begins September 1, 1961.

The new president has been a member of Controllers Institute since 1942. He served on its board of directors, 1950-53, and during that period was chairman of the Executive Committee, 1951-52, and vice president, 1952-53.

He was president of the New York City Control, 1947-48, and held the office of general chairman of the Institute's 17th Annual Conference in New York in October 1948. In 1956 he served as vice chairman of the CIA 25th Anniversary Conference in New York.

In the six-year period, 1954-60, Mr. Boschen was a trustee of Controllers Institute Research Foundation, and for two years in that period, 1955-57, a vice president of the research group. He is currently chairman of the Review Panel of the CIRF research project on "Measuring the Effectiveness of Marketing Costs," which will be published later this year.

Mr. Boschen began his business career, after attending Cornell University, as a credit reporter and analyst for Dun & Bradstreet in 1932. He joined Vick Chemical Co. (former name of Richardson-Merrell Inc.) as a junior accountant. In 1942 he was appointed acting comptroller, and a year later was elected comptroller. He became vice president and comptroller in 1953 and was elected vice president-finance in 1959. He is a director of the Reinsurance Corporation of New York and several Richardson-Merrell subsidiaries.

The president-elect lives in Rye, N. Y., and is a member of the American Yacht Club, of which he is treasurer and a former trustee; a member of the Cornell Club of New York, as well as former treasurer and trustee of the Presbyterian Church in the town of Rye.

FRANK S. CAPON, 1960-61 president of Controllers Institute, the first Canadian to hold that position, now moves to the chairmanship of the board on the same date. Mr. Capon is vice president of Du Pont of Canada Ltd., Montreal, Quebec.

ROGER A. YODER, vice president-finance, Detroit Steel Corporation, Detroit, Michigan, who served as chairman of the board for 1960-61, was made a director at large for a period of two years.

TREASURER for the fiscal year, 1961-62 is **Victor L. Persbacker,** comptroller, American Brake Shoe Company, New York (re-elected).

ASSISTANT TREASURER for the 1961-62 term is **George N. Farrand,** treasurer, Young & Rubicam, Inc., New York (re-elected).

CIA NEWS

. . . and Other Officers Elected for 1961-62 from Six Areas

AREA VICE PRESIDENTS

At the meeting of the board of directors of Controllers Institute held in conjunction with the Northeastern Area Conference at Lake Placid, N. Y., the following members were elected as area vice presidents:

Northeastern Area—Harold L. Gebike, secretary-treasurer, Electro Refractories & Abrasives Corp., Buffalo, N. Y.

Eastern Area—Gerald L. Phillippe, comptroller, General Electric Company, New York.

North Central Area—Paul R. Langdon, manager-finance and accounting, Battelle Memorial Institute, Columbus, Ohio.

Southern Area—Leland K. MacFarland, secretary-treasurer, Kingwood Oil Company, Oklahoma City, Okla.

Midwestern Area—Herbert F. Walton, vice president, Allstate Insurance Company, Skokie, Illinois.

Western Area—Stanley B. Murray, vice president and controller, M.J.B. Company, San Francisco, California.

The vice presidents will assume office on September 1, 1961 for one year.

HAROLD L. GEBIKE
Northeastern

GERALD L. PHILLIPPE
Eastern

PAUL R. LANGDON
North Central

LELAND K. MACFARLAND
Southern

HERBERT F. WALTON
Midwestern

STANLEY B. MURRAY
Western

Mergers

(Continued from page 340)

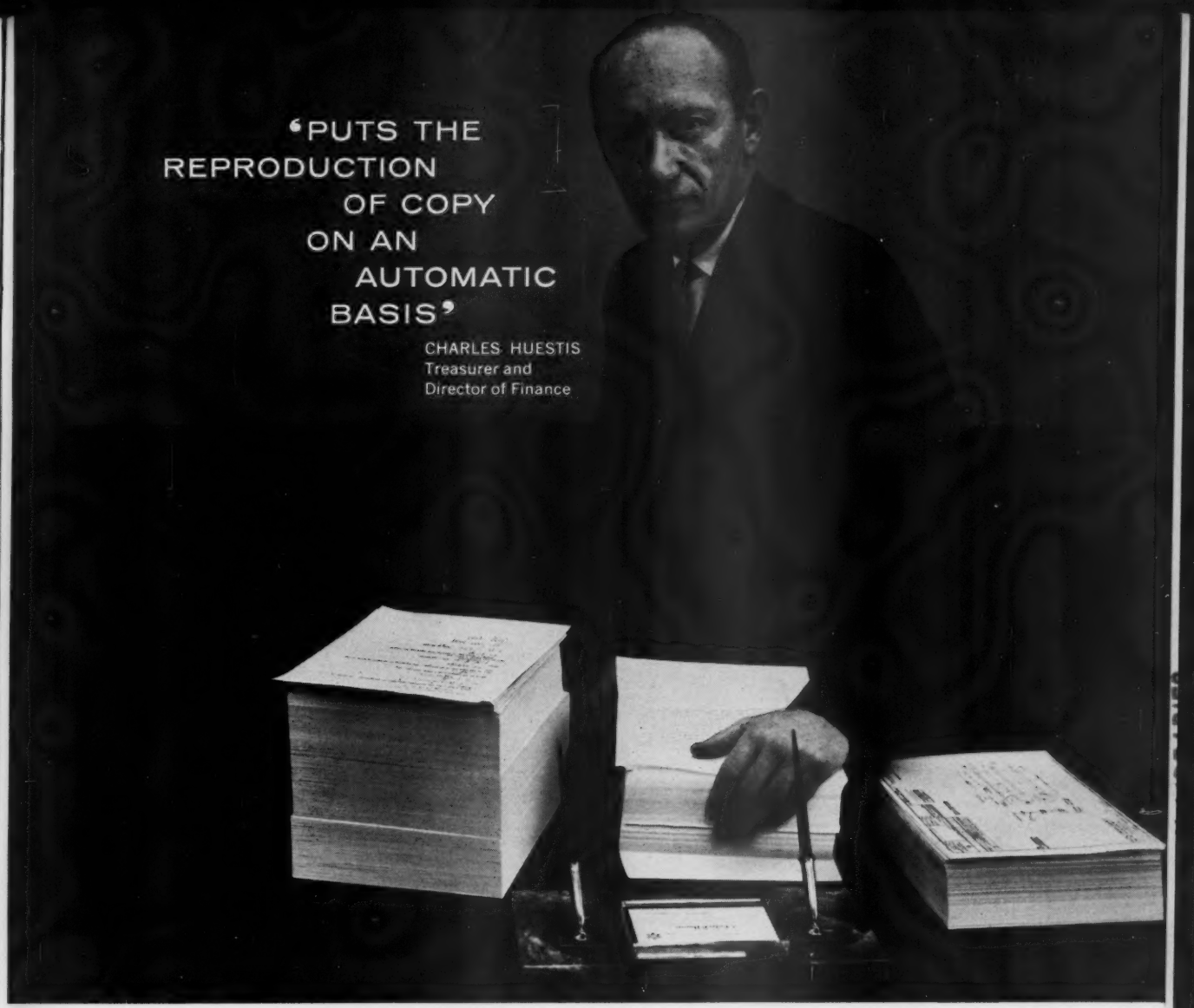
lished by Von Neumann and Morgenstern. Later works have explained the basic elements of the theory in less mathematical terms which can easily be followed.

If we examine the odds that have been calculated for the game, we can see that the best strategy for our company is 4:4:1, while the best strategy for our competitor is 1:0:2. If each player follows his best mixed strategy he will insure that over the long run the results will be as favorable as possible to him (maximum gain or minimum loss), and that the net value over the long run will be the value of the game from the odds and the pay-offs, the value of our game can be calculated at 4⅓. Because this value is greater than zero, the game is plainly unfair to our competitor.

As we have already discussed, a mixed strategy is of little value to us because the game will probably only consist of one move. Thus, the solution does not tell us exactly which move to choose. However, it does tell us that if our competitor chooses Company B, he will be making his worst possible move, because it does not enter into his best mixed strategy. This knowledge will be significant if we are playing against an unenlightened competitor. We can only hope that he did not read this paper.

To summarize, let us consider what the application of scientific methods and mathematics contributed to the acquisition decision problem that we have illustrated. It is apparent that the scientific method did not solve the problem or make the decision itself, contrary to the fears of many thinking businessmen. However, it did aid in structuring the decision, clarifying the relationships involved, and revealing the sensitivity of pertinent factors. By measuring values in a quantitative manner and introducing the concept of probability, the scientific method helped to bring logic and insight into this otherwise intangible decision problem.

YUM



Copyflo® 11 Printer saving Hughes $300,000 a year

A Copyflo 11 continuous printer is saving Hughes Aircraft Company more than $300,000 a year in the reproduction of engineering drawings, correspondence, reports, and administrative documents. Engineering prints, however, form the bulk of the copying work.

So fast is the Copyflo continuous printer in comparison to manual reproduction methods previously used that Charles Huestis, Hughes' treasurer, says, "It puts the reproduction of copy on an automatic basis."

This is scarcely an overstatement. A Copyflo continuous printer automatically turns out a *different* 8½"x11" print every three seconds, an 11"x17" print every six seconds.

A Copyflo continuous printer automatically produces—at the rate of 20 linear feet a minute—dry, positive prints or offset paper masters, ready for immediate use. The machine operates on the principles of xerography—clean, fast, completely dry—copying anything written, printed, typed, or drawn.

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The volume of *your* daily copying may well justify a Copyflo continuous printer, too. Why not find out *now* how much you can expect to save in time, money, space, and materials? Let our trained systems and procedures man make a free analysis of your paperwork-duplicating needs. Write XEROX CORPORATION (formerly Haloid Xerox Inc.), 61-127X Haloid St., Rochester 3, N.Y. Branch offices: principal U.S. and Canadian cities. *Overseas:* Rank-Xerox Ltd., London.

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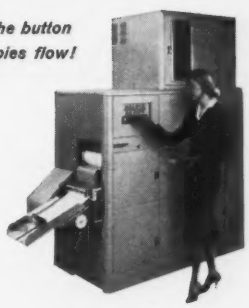

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New IBM Inventory Management Simulator

Management pre-tests inventory de

How often have you wanted to peer into the future... see the probable results of your inventory policy? **Now you can.** An IBM data processing technique—Inventory Management Simulation—establishes the computer as an invaluable management tool for problem solving and decision making.

This technique lets you test and evaluate alternate plans electronically without disrupting present operations. In effect, it lets you turn *hindsight* into *foresight*.

Simulation is performed by creating within the computer a mathematical model of an inventory control system. Then the model is subjected to various demand situations. In every case, the computer reports what would have happened had this particular system been used to handle each situation. Of course, both the model and the demand factors can be endlessly varied.

Here's the important thing: Through simulation, the trial-and-error method of determining a course of action is performed within the computer—not during the course of your firm's business. This gives you a fast way to test plans under a wide range of conditions before actually putting them

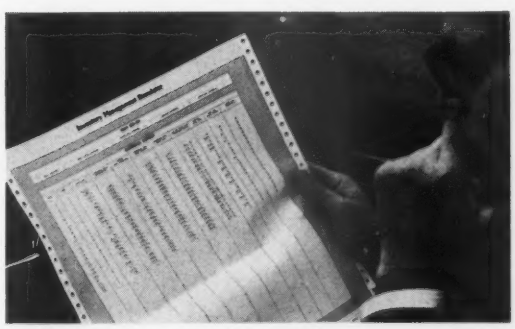
LOOKING AHEAD. Management has run a computer simulation of a proposed inventory plan. Company executives (above) now examine charted results showing how the plan might work, what problems might arise, where improvement might be sought. Print-out sheet (below) from an IBM computer contains facts needed to judge long-range results of a given inventory control plan. Inventory Management Simulation takes much of the guesswork out of planning.

ry decisions with electronic speed

to use. Unprofitable or inadequate courses of action show up in advance. You avoid them. And you select with confidence the system best suited to your firm's objectives.

Getting started. If you are an IBM customer, you can take advantage of the Inventory Management Simulation Program at once. IBM helps you collect the facts you need... and helps you set up a computer program to analyze them.

Ask your IBM representative to show you how this new technique can uncover *your* most effective inventory policy.



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They say that once there was a statistician whose firm had just put him in charge of a new computer.

Amazed at the speed and accuracy of the machine in solving complicated problems, he decided to put it to the ultimate test by asking this tough question: "Is there a God?"

The machine answered: "There is now."

Management Looks at Computopia

DUDLEY BROWNE, *vice president-finance of the Lockheed Aircraft Corporation, Burbank, California, addressed a recent meeting of the Univac Users Association as follows:*

Fellow users of EDP equipment:

For the moment, let's let others hold the technical discussions. Let us instead just browse around in computerland for a few minutes and indulge in some idle speculation about the road ahead.

I have coined a word—"Computopia"—to suggest the promised land to which the prophets of data processing are leading us. I confess I do not know the exact outlines of this brave new world. Nor, I think, do the prophets themselves. But prophets seldom do. In this, as in so many other things, we proceed by faith, and those of us whose vision is blurred and whose hearts are uneasy must quell our fears and follow bravely those who lead the way.

But let me reassure you. If my own vision is somewhat dim, I am nevertheless on the side of the Computopians. The advances made in the development and application of electronic data-processing systems in the last decade leave no doubt that theirs is the tide of the future. We in management cannot contravene it. We cannot, like King Canute, stand on the shore and order the tide to recede. Nor do we want to.

But we will, I think, ask questions. And we will occasionally temper the enthusiasm of its more ardent advocates by a more cautious approach than some of them would like to see.

I know that occasionally this caution must seem like a difficult cross for the Computopians to bear. They are plagued on the one hand by the task of mastering the complicated technology involved and, on the other, by the problems of research in management methodology. They are confronted with suspicion and even hostility among the people they seek to "liberate" or, as the tactless put it, replace. With all these problems, it must seem doubly hard when management—that same management they try so hard to improve—holds back and drags its feet.

But, if it's any consolation, this is the classic lot of all reformers and visionaries. The road to Utopia has never been an easy one.

Let's, as a starting point, take a look at the Computopia that is envisioned for, say, the year 1970. Perhaps the date isn't exact, and, of course, this by no means represents the ultimate Computopia. But it is an important way station.

In our Computopian factory, data processing operates as a complete system in which a single event—for example, a customer's order—creates an automatic chain reaction through sales, credit, engineering production, scheduling, personnel, stockrooms, and so on. Accounting and bookkeeping are automatic by-products. Communication is on a real-time basis, providing information related to the urgency of the situation. Historical data are filed in invisible electronic form. Computers make routine decisions automatically, freeing management for dealing with the exceptional case—and presumably we shall know what the exception is. Complete and current information is immediately available to management to assist in making policy decisions. Management will be able to test its policy changes on a computer simulated model of company operations.

There will, of course, be personnel changes. In the Computopia of 1970 there will be less need for the semiskilled and even skilled clerical help whose work can be turned over to the computer. Automation on the production side will have replaced many of the unskilled production workers. There will, of course, be increased opportunities for the servants of the computer—the programmers, the technicians, the systems analysts. And I am happy to report that we in management have been assured that we shall still be around—at least in 1970, though I have the uneasy feeling that in the ultimate Computopia of, say the year 2100, the Computopians are laying plans to have the computer take over our jobs as well.

How much of this Computopia will be realized in this decade?

A very great deal, I should think. I am sufficiently impressed by the past accomplishments of science to realize that almost nothing is impossible on the scientific side, and I am sure that progress in the technical area will continue at its present spectacular rate. Science will come up with ever more sophisticated and reliable pieces of hardware, and the problem will not be lack of equipment but rather of learning how to use it.

One area where technology, economics, and systems knowledge will combine to produce great advances is in the area of communications. It seems imminent that we shall have networks of digital transmission facilities linking multiplant units and even different companies and cities together through data-processing centers. We shall be able to move data and process them in a matter of seconds as opposed to days.

Our systems people have assured me that the private communications network we have recently installed in our own company will soon permit us to transmit data at the rate of one half million bits per second.

How can anyone fail to be high on technological advances in the face of things like this?

I am sure we will make some progress on the road to Computopia, but there also will be stumbling blocks on the road, and I think we should take a look at some of them.

First, there will be the obstacles that seem to be imposed by management itself. We know that management's experience with automated operations and data-processing systems has not always been good. Very likely these troubles have been the result of ill-advised haste, or overselling on the part of overenthusiastic supporters, or simply management error in trying to make computers do something for which they were not intended. Very often, I suspect, companies have made the mistake of overcomputerizing. They have been lured into systems that are too big, too general, for the specific jobs they have had to do.

Certainly there are answers here—better analysis to begin with, less concern with the status value of large systems. One development that seems promising to me is the special-purpose computer, tailored to do a specific job. Examples are the credit card computer that estimates the degree of credit risk, the survey computer that assists the surveyor in his trigonometric computations, the automatic bulk-loading computer to control fuel flow and maintain inventories, the critical path-scheduler computer to forecast critical obstacles to flow of some item or process. One could go on and on. The point is that these are designed to do a specific

job. They appeal to cost-conscious management because they are not too big—they don't have waste or unused capacity.

Whether or not these types of computers provide some of the answers of the future, it is understandable that some of the experiences of the past have made management a little bit cautious. It has made us wonder.

We have wondered, for example, about the high ratio of fixed costs an electronic data-processing system represents—a ratio that pushes breakeven expenses skyhigh and demands high-volume operation to come out ahead.

What happens when we are forced to contract? Can we lay off a computer the way we lay off an employe?

We have wondered, too, about flexibility. Some of us feel that massive data-processing installations commit us to a monolithic systems structure that makes change costly or even impossible. It is a serious thing to commit yourself to a system that locks you in. At least in Lockheed's case, flexibility is a managerial ideal—almost a necessity in this rapidly changing world—and it is an ideal that we will not willingly sacrifice.

We wonder about other things too—things chiefly concerned with the cost of these installations, the cost of the proliferation of computer centers, their effect upon the costs of decentralization. And we wonder, also, about the answers to those final problems of Computopia—the programming of the "*assumed* logic" of management and the realistic simulation of management problems leading to help in policy solutions.

I know that there are answers to these questions—or partial answers. And I know that many of the answers hinge around the development of more research into management itself—what management needs, how management makes decisions. I recognize the need for this kind of research, and I know that in many university centers and elsewhere it has already started. But I imagine it will be much more difficult than some of the Computopians think.

I doubt, for example, that they can discover how executive decisions are made merely by following an executive around and jotting down his thoughts and actions on a pad. I am afraid they will have to peer into the subconscious parts of his mind. This is something medical people and psychologists have been trying to do for decades—and with disappointing results.

It may be that one can never automate decisions in which faith and intuition and imagination and inspiration play an important part. And if any doubt exists as to the rough road ahead, consider Las Vegas—*is it not an idolistic monument to disbelief in the laws of probability?*

But the objections and the questions raised by management may be the smallest of the stumbling blocks the Computopians will encounter. Somehow I am sure they will find answers—acceptable if not complete—and the tide of the future will sweep away most of the lingering managerial doubts.

There will remain the social problem, and this is one I think must be faced. I know that it is easy to take the position that this is somebody else's problem—that Computopians are the servants of science and not the diplomats of destiny. And yet I suggest that their efforts are changing the face of the future and that they cannot escape responsibility simply by turning their backs.

I know some are inclined to do this. I know some attempt to shrug off any responsibility by shifting the job to someone else. I know some simply ignore it—I know several who will not even use the word "automation" because they know it is emotionally charged and hope that, if they ignore the problem, maybe it will go away.

But it won't go away. It is already becoming an issue with labor unions in this time of abnormal unemployment, and it will persist as a problem until it is solved. It is not enough for us to try to solve it with such easy platitudes as that in the long run the computer will create more jobs than it destroys or that it will liberate human beings from the drudgery and

(Continued on page 348)

COMPUTER NETWORKS

Reviewing the newest IBM products development, President Thomas J. Watson, Jr., singled out IBM Tele-Processing, a means of tying computers together into networks. IBM Tele-Processing, together with IBM's new solid state computers, makes it possible to create world-wide information systems in which data accumulated in such diverse cities as London, Paris, Frankfort and Rome could be flashed back to New York, processed, and sent back again within seconds. Such systems are now being planned for the early future.

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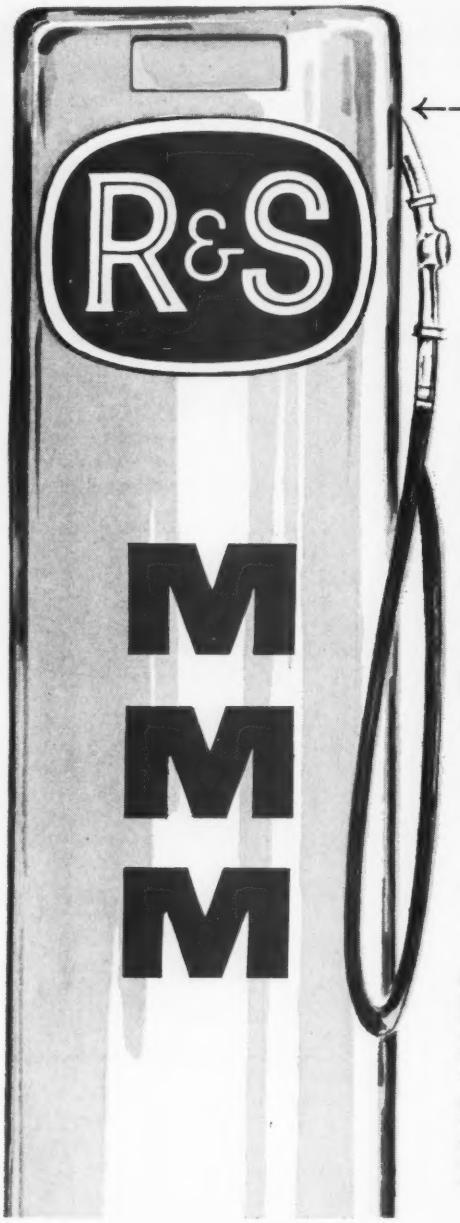

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Management Looks at Computopia

(Continued from page 347)

monotony of repetitive work. These things may indeed be true—as I am sure they are—but the further questions remain: *What do we do about the short run?* and *Liberate people for what?*

The role of man in the ultimate Computopia is one I think we should give some attention to. For Computopia must be meaningful to man before it becomes accepted.

I do not think the promise of leisure time is meaningful alone, without some indication of how it may be meaningfully employed. I am not sure that a world that has a place only for the scientists, the engineers, the professional people, the highly skilled, is a world that the majority of American people can be comfortable in, no matter how high the gross national product. And I am not sure that a world in which people are described as "human links" in a vast data-processing or automated system is a world that anyone would buy.

I recall that Thomas More's Utopians, back around 1500, placed man at the center of their ideal universe. They wondered how normal men, for whom wealth was made and by whom it has value, could ever be thought of less value than this wealth. And today, I think, we must wonder if man can ever be thought of less value than the computer he creates.

These things that you have heard before I mention today as part of a plea for tolerance and understanding for all those who seem to place unnecessary stumbling blocks in the way of achieving Computopia—for the conservative, hard-headed management that will not always keep pace, for the threatened job-holder more concerned with his short-term personal problem than with the long-term general good, for the social philosopher who insists on raising questions of ultimate values when EDP systems producers and programmers are only trying to do a job.

In spite of the difficulties I have suggested, I am sure that Computopia is coming. If you will permit me one more observation, I am equally sure it will never completely arrive. Utopias of all kinds have a way of eluding us, at the end, and looking back it may be that the real Utopia is in the process of striving, not in the achievement. If this is true, then Computopia is already here.

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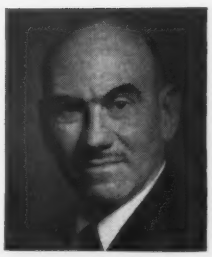

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Bowmar Instrument Corp.
Fort Wayne

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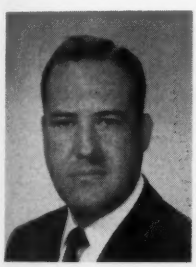
The Arrow-Hart & Hegeman Electric Co.
Hartford



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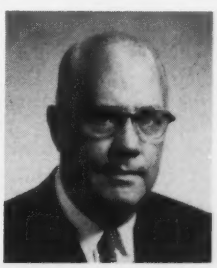
New Orleans



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VOLNEY PRATT
The First National Bank of Oregon
Portland

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Package Machinery Company
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D. C. McCONKEY
Canadian Gypsum Company, Ltd.
Toronto

* SECTIONS II & III each comprising 18 more Controls will appear in the August and September issues of THE CONTROLLER

Depreciation Reform on the Slate?

New proposals, speeches, hearings herald almost certain steps that the 87th Congress will take this year towards providing industry with long-needed incentives to increase its investment in new plant and equipment. But the measures which seem to be receiving the most serious consideration are not those considered most vital by industry itself.

Where industry has looked for reform of the provisions under which it is allowed to depreciate—set aside money to modernize and replace—its old equipment, it now appears to be faced with the likelihood of legislation skipping over this vital phase of the problem and setting up an outright tax credit for investment in new equipment.

Industry does not sound happy with the substitution. One of its most articulate spokesmen* says: "We recommend real depreciation reform in preference to the tax credit approach."

What does industry want?

Judging by its response to the Treasury Department's own Depreciation Survey questionnaire, it wants, first, freedom to follow its own judgment as to accounting methods and equipment "lives" for depreciation purposes, so long as it remains consistent in establishing those lives and following those methods. Secondly, it wants some form of depreciation adjustment to reflect increased price levels—that is, it wants to see some "revaluation factors" recognized and established.

What has the present administration offered?

The administration has offered a tax credit against money spent over and above the amount of a company's current-year depreciation.

THIRTY-YEAR HISTORY

If "real depreciation reform" does not come this year, when prospects appeared brightest, then the year must become another milestone for industry in a melancholy 30-year history of not getting the kind of tax treatment that it wants.

The Treasury Department's archaic schedule of allowable rates of depreciation goes all the way back to 1934 and a desperate administration's need to maximize, at all costs, taxable corporate income. In the opinion of Joel Barlow, chairman of the Taxation Committee of the Chamber of Commerce of the United States, there is no question but that the schedule, as well as the whole complex of regulations which have continued down to the present day, was "a revenue-raising measure pure and simple. It was not designed with the obsolescence cycle nor with modernization and replacement at all in mind. It was not designed to let a taxpayer recover his investment in a reasonable period of time nor to encourage him to replace and expand. It was not depreciation policy for economic growth but a tax-collection measure to finance a short-range welfare program in a depression. It has controlled the thinking of nearly every [Treasury] agent for over 25 years."

True, the 1954 overhaul of federal tax policy produced some amelioration. The Internal Revenue Code of that year authorized the use of two new methods of determining depreciation, in addition to the traditional straight-line method. "Double-rate-declining-balance" and "sum-of-the-digits" permitted a taxpayer to write off the cost of an asset more rapidly during the first years of its life, but these new methods had no effect on the length of the period—the life—over which the total write-off had to be made.

They were thus, at best, only a step in the right direction. They did not offer any long-range solution to the problem of adjusting the tax laws to the swift pace of obsolescence that has been induced by a rapidly advancing technology.

FOREIGN GAINS, U.S. LOSSES

Meanwhile, in the years from 1953 to 1960, the United States lagged farther and farther behind its seven major competitors in economic growth and industrial expansion. According to a study made by the Machinery and Allied Products Institute, 1960 production among the eight stood at the following levels, expressed as percentages of production in 1953:

Japan	258	Sweden	134
Italy	181	England	128
West Germany	180	Canada	127
France	172	United States	119

Significantly, every one of the seven except West Germany allows far more rapid write-offs of building and equipment costs than does the United States. Even more significantly, West Germany recently reduced its rates to the level allowed in the United States to *halt* an investment boom which it felt to be excessive.

Not only in the matter of accelerated rates of write-off, but in other areas of incentive-creating depreciation policy, the United States system appears to be, in the words of the Machinery and Allied Products Institute, "the worst tax depreciation system of any major industrial country in the world."

The accompanying chart, reproduced through the courtesy of *Chemical Week* magazine, shows some of the special provisions which have been adopted to encourage capital-asset investment abroad.

BY-PASSING REFORM

However, none of these provisions appears to be in the present administration's immediate plans for tax-policy changes in this country. Instead, it has proposed a measure which would by-pass reform of present provisions for depreciation and simply establish a tax credit for company expenditures on new plant and equipment.

The credit would cover only new plant addition or equipment with the useful life of six or more years. On qualifying expenditures there would be a minimum credit—a flat 10 per cent of any qualifying outlay up to $5,000. In lieu of the minimum, if a higher credit could be secured thereby, a taxpayer would be allowed 15 per cent of all qualifying outlays in excess of current-year depreciation, plus six per cent of such outlays below the level of current-year depreciation but in excess of 50 per cent of that level.

Testifying May 17, 1961 before the House Ways and Means Committee on the proposed legislation, Frank V. Olds stated:

"The tax credit proposal is a variable-rate, direct tax credit with the tax credit based on the relationship of a company's capital spending to its depreciation. By establishing an eligibility threshold—in this case, the amount of annual depreciation—and by providing a significantly greater credit above the threshold, it would appear that the urge to manipulate the threshold would be very strong.

"The Administration's tax credit plan would not be an integral part of depreciation accounting. For this reason, it is more subject to change by legislative

* Frank V. Olds, assistant comptroller of the Chrysler Corporation and chairman of the Committee on Federal Taxation of Controllers Institute of America.

whim. Whether real or assumed, such an appearance will not stimulate the confidence necessary for encouraging greater long-range plans for investment.

"The Administration proposal as presented to your Committee would result in little or no incentive this year, very little incentive in 1962, and the maximum incentive would not be reached in many cases until 1964 or later. This situation results from the proposal that the tax credit be applicable only to expenditures made since January 1 of this year and only in the case of property put in place. The majority of capital expenditures require 18 months to three years to be put in place.

OTHER TAX-CREDIT DRAWBACKS

"Beyond the technical aspects of the Administration proposal, there are several other items to consider concerning the tax-credit approach.

"1. The tax credit represents only a partial correction of the twin problems facing industry with regard to capital expenditures; that is, inflation and the rapid obsolescence brought about by technology.

"2. It puts too much emphasis on ex-

(Continued on page 352)

Depreciation provisions used	Re-valuation factors applied	Depreciation above cost (without re-valuation or above revaluated cost)	Additional write-off in first year (or in first 3-4 years*	Accelerated rates (above U.S. rates allowed)	Shorter lives (than allowed in U.S.)	Bracket system (grouping classes of assets as to depreciable lives)
	1		2	3		4
ARGENTINA	■	■	■	■	■	■
AUSTRALIA	■	■	■	■	■	■
BELGIUM	■	■	*	■	■	■
BRAZIL	■	■	■	■	■	■
CANADA	■	■	■	■	■	■
CHILE	■	■	■	■	■	■
COLOMBIA	■	■	■	■	■	■
DENMARK	■	■	■	■	■	■
FRANCE	■	■	■	■	■	■
GERMANY	■	■	■	■	■	■
GREAT BRITAIN	■	■	■	■	■	■
HOLLAND	■	■	*	■	■	■
INDIA	■	■	■	■	■	■
ITALY	■	■	■	■	■	■
JAPAN	■	■	■	■	■	■
MEXICO	■	■	■	■	■	■
NORWAY	■	■	■	■	■	■
SWEDEN	■	■	■	■	■	■

How Foreign Countries Handle Depreciation

1 Inflation coefficients applied in revaluing assets; permits depreciation to be stated on current cost basis. Generally, inflation factor is determined for various periods rather than for individual years. Example: Brazil has applied these revaluation factors by years of acquisition: 1929 and earlier, 13 times original cost; 1949 and '50, 3.4 times original cost; 1956, 1.3 times cost.

2 Most of the countries listed permit additional allowances in either the year of acquisition or in the first 3-4 years, as an incentive for modernization. In Great Britain, Belgium, Holland, and Sweden this amounts to 30-33⅓%; in Argentina, it's as high as 50%.

3 With few exceptions, the depreciation rates subsequent to the year of acquisition are higher than those allowed in the U.S. Germany, for example, allows a declining-balance calculation at double straight life but not to exceed 20%. Holland bases the depreciable period on economic life, not necessarily technical life; this is most commonly held around 10%.

4 Canada uses a bracket system for grouping assets, divides these into 17 classes. The rate of depreciation for each class is more liberal than allowed in U.S., and the taxpayer has the option of varying the rate from year to year within maximum limits.

Source: Statement by Maurice E. Peloubet at hearings on depreciation reform, November, 1959, before Committee on Ways and Means of House of Representatives. Chart reprinted from *Chemical Week*.

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THROUGHOUT THE U. S. AND WORLD

pansion and not enough on modernization, and could result in current borrowing from future investment.

"3. The limitation restricting the tax credit to 30 per cent of taxes otherwise payable practically eliminates the incentive for the marginal producer who has little or no profit at the present time and who actually needs the greatest incentive."

Mr. Olds went on to say that, while certain changes might improve the tax-credit approach, "we believe that other methods, more consistent with accepted business and accounting practices, would be more productive of the Administration's objectives.

"Our recommendations for real depreciation reform are:

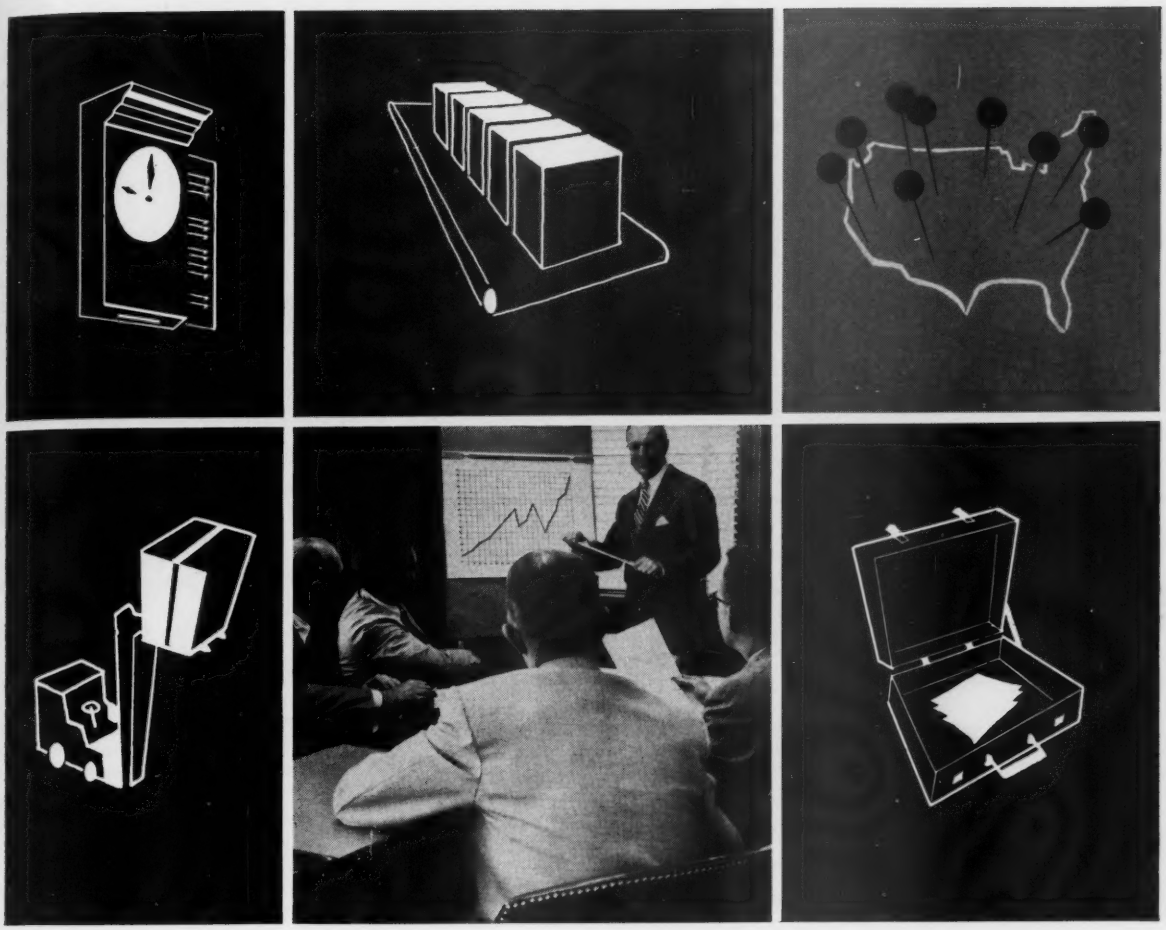
"1. Provision should be made whereby there is created a statutory presumption of correctness when service lives used for tax purposes are no shorter than those used by the taxpayer in determining depreciation reported in his regular books of account.

"2. Section 167 [of the Internal Revenue Code] should be modified to permit a taxpayer to change depreciation methods or rates as the conditions applicable to his business require, and he should be accorded the automatic right to shift at his option between the methods available under Section 167 (b).

"3. Salvage value should be specifically permitted to be excluded as a factor in the determination of depreciation allowances. Collateral to the adoption of such a provision, Section 1231 might be amended in such manner that the net proceeds from the sale or other disposition of depreciable assets would be taxed as ordinary income to the extent of the original cost of the assets disposed of. Proceeds in excess of original cost should, however, continue to receive treatment as capital gains.

"4. Provisions should be added under Section 167 recognizing cost-level depreciation. Various methods have been suggested to implement this proposal. We believe the most practical of these to be a procedure whereby depreciation computed on the basis of historical cost would be adjusted in relation to a generally accepted index of the current cost of taxpayer's depreciable property to its historical cost. For practical purposes, and as an element of control where this approach is selected, the actual depreciation allowance should be limited to the amount recognized by the taxpayer in his books of account.

"These suggestions constitute reasonable and comprehensive depreciation reform—provision for realistic lives and some recognition of the impact of inflation. The adoption of these proposals would provide incentives on which industry could move ahead with confidence."



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The bank has leased data-processing equipment in agreement with the Bendix Company, which will enable it to sell the center's service on a time and fee basis to any business in the state and in pre-selected areas in bordering states. The bank's president firmly stated "these services will not be furnished free in exchange for deposit accounts or increases in deposit balances."

The service will be priced to be profitable to the bank as well as economical to even small business firms. It is planned that two thirds of the center's time will be used to process large quantities of business and industrial data and the remaining time will be utilized by the bank for its accounting work.

To familiarize businessmen with the center's operation, a series of special data-processing seminars will be conducted by the bank. These sessions will serve to introduce the new technology to many organizations which do not have computing machinery. The bank is hopeful that the project will stimulate the economic growth of the community and the state and become a pattern for other banks.

EDP Extends to Foreign Languages

Two electronic converters, designed to accommodate the Japanese as well as the English language, have been sold by the Digitronics Corporation, Albertson, N. Y., to Remington Rand International, for use in Japan. Normally converters provide for an alphabet of 26 characters. To handle data in both English and Japanese, equipment had to be created capable of providing 96 characters.

Since Japanese teletype facilities differ from American standards, Digitronics had to adapt their equipment, including punches and readers, to conform to the Japanese standards.

The sale of the two converters, to be used by the Tokyo Electric Power, Inc., in conjunction with their Univac installation, included an innovation in the servicing of electronic equipment. In addition to having their own engineers install the equipment in Japan, Digitronics is training a group of Japanese engineers in their Albertson plant for purposes of local servicing. Beyond this, Digitronics has agreed to provide "on-call" service to back up Japanese engineers on the local scene whenever necessary. This is believed to be the first such service arrangement of its kind.

Purdue EDP Fellowships

During the recent ceremonies dedicating a new Univac electronic data-processing system at Purdue University's Statistics and Computer Laboratory, the Univac Division of Sperry Rand Corporation presented two graduate fellowships to Purdue to provide financial assistance for graduate students pursuing a course of study related to electronic data processing.

Purdue plans to explore new uses of computers in education—such innovations as marketing simulations and the use of computers as teachers—and will use the Univac solid-state 80-tape system for administrative recordkeeping; the Univac Division of Sperry Rand will use the system for customer education, training salesmen and customer program-testing for the Division's Midwest Marketing Region.

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Effective Use of Business Consultants

To complete work on the study and on a manuscript embodying the results of the study, "Effective Use of Business Consultants," Controllers Institute Research Foundation has retained Wilson Seney, management consultant and organizer of the Wilson Seney Seminars for Executives. Mr. Seney has promised delivery of the manuscript in time for a publication date early in 1962.

Sponsors of the study have found that a great many changes have taken place in the ten years since an earlier study was published. Among other things, they find a much greater use of consultants now. This is due, of course, to the need that has developed for men with increased professional and technical skills and to the fact that most companies, when the time comes to use men proficient in these matters, do not have them on the payroll.

The present tendency seems to be to use consultants first, to get new projects started; then to train people in the company to proceed without the consultants.

By no means do all large firms use consultants, however, to judge from the results of a questionnaire sent out in connection with the study. Thirty per cent of the respondents—representative financial executives—report that they either do not use consultants or have not used any during the last few years. Quite a few indicate that they earlier foresaw the need for more specially trained employes and have not therefore found it necessary lately to call in outside technical help.

One puts it very concisely: "We would use consultants when and if there was a need." Another writes: "We have just passed the 500-employe mark and are growing rapidly. The use of management consultants has been discussed more and more lately, and we will probably use them on a small scale within the coming years." Many managers will feel sympathetic to the controller who states: "This is a subsidiary—we have lots of consultants."

Two other quotations indicate the state of mind that some companies have concerning consultants. One states: "We prefer to solve our own problems. We feel that we know our condition better than any outside consultants." Another says: "No outsider can tell the owner of this company how to run his business."

But of this 30 per cent who sometimes so emphatically report that they have not used consultants recently, a number have used them in the past. In some cases the results were satisfactory; in other cases they were not. One respondent indicates the fears of quite a few regarding consultants when he says: "If consultant services are used, be sure to limit them to the project involved and terminate their services as soon as they are completed. Avoid an expensive policing function which can drag on for months."

The reasons given by the almost 70 per cent *who do use consultants* are quite revealing. One says: "This is a decision of the board of directors—will use outside consultants any time they feel results dictate." Another says: "Used in advisory capacity to our own staff only." A third writes: "We would use them in matters where our own staff is not qualified or is too busy to devote the required time. We would also use them where it is felt that independent recommendation would be particularly pertinent."

A few used consultants a great many times; as many as 50-60 times on as many projects, some stated. The reasons given for the use of consultants in these cases are most illuminating.

One writes: "It is the general practice to employ business consultants to assist in solving administrative or technical problems in select areas where equivalent staff's service or counsel is unavailable."

Another writes: "We favor the use of consultants after a thorough study of the requirements of the particular situation; they are basically used as (1) an aid to management, (2) for the development of specific programs, and (3) as a supplement to a staff department."

One states: "It is our policy to use management consultants in the following situations: (a) where we do not have the technical experience in our own staff to solve a specific problem, and upon solution of the problem, will not need a full-time staff; (b) to train our own employes in the application of a new technique which may or may not be an exclusive property of the consultant; (c) where our own staff does have the technical experience, but needs assistance on an urgent project or to relieve a backlog of unfinished projects."

Another states: "We operate a management-services and operations-research division of our own. However, we use numerous consultants to supplement our own staff."

Despite the holdout firms and the firms that try to limit the area of employment of management consultants, it is clear that in the aggregate of the remaining firms there is hardly a function or service for which consultants are not sometimes called in. The final chapter in this new manuscript on the "Effective Use of Consultants" will draw some specific and concrete conclusions on the manner in which a company can make the wisest use of their services.

One Fewer Federal Report

The Census Bureau's second thoughts about a proposed "Annual Company Survey" may reflect increased consideration by government officials of industry's burden of supplying data for such surveys. The Bureau recently cancelled the survey—for the present, at any rate—after fully formulating plans which would have required 6,000 of the nation's largest companies to report data on mergers, acquisitions and dispositions of other firms, total employment of parent and subsidiaries, and consolidated financial statistics.

Our source of news of the cancellation is industry's Advisory Council on Federal Reports, which has provided and continues to provide invaluable services of liaison and advice in government-industry negotiations and conferences about statistical reports.

United Nuclear Service

Plans for a new $25 million corporation which will be the nation's first integrated organization in the field of nuclear energy has been announced by three leading companies in the nuclear field—Olin Mathieson Chemical Corporation, Nuclear Development Corporation of America (NDA) and Mallinckrodt Chemical Works. The new company called United Nuclear will have total employment of approximately 1400 persons. It will have skills and facilities for research and development, reactor system design, manufacture of nuclear fuel materials, reactor and core fabrications, fuel management, cold scrap processing, isotopes and hot radiation energy sources. It will also have personnel skilled in hot core transportation,

hot scrap reprocessing and hot waste disposal. This first integrated nuclear service organization in the United States will serve both commercial and government customers.

The decision to form the new corporation was based on four considerations:

1. Interest by electric power utilities and government in obtaining a wider range of nuclear services from a single integrated organization than are available today.
2. The growing demand for isotopes, "hot" fission products and compact nuclear power sources for military, space projects, and commercial applications.
3. The growing need for "hot" scrap reprocessing, i.e., the recovery of unspent fuel, isotopes and other irradiated materials by reprocessing spent fuel elements and cores.
4. The Government's expressed desire to induce private industry to enter other areas, such as "hot" scrap reprocessing, which have been mainly the province of the Government.

For Statistics Fans

An innovation of the past few years is the designing of space for data-processing machines in offices. These often require special floor construction, sufficient source of power and special air conditioning. It takes six times as much air conditioning for automated equipment as it does for regular offices, and space for self-operating, auxiliary power systems must be provided for emergencies.

•

The labor movement now represents a smaller percentage of the work force than it did in 1953 at which time unions had 40 per cent of what Jack Livingston, director of organization for the AFL-CIO, calls the organizable work force, which excludes professionals, farm laborers and domestics. The work force has grown in the interim but the union movement has not, so that unions at present represent only 38 per cent of the work force.

•

Trade sources said that American industry leased more than $530 million worth of production and office equipment in 1960 compared with a leasing volume of $392 million in 1959. The figures do not include leasing of cars, trucks, railroad rolling stock, real estate and buildings. The main reason for the volume rise is that working capital remains tight for most businesses.

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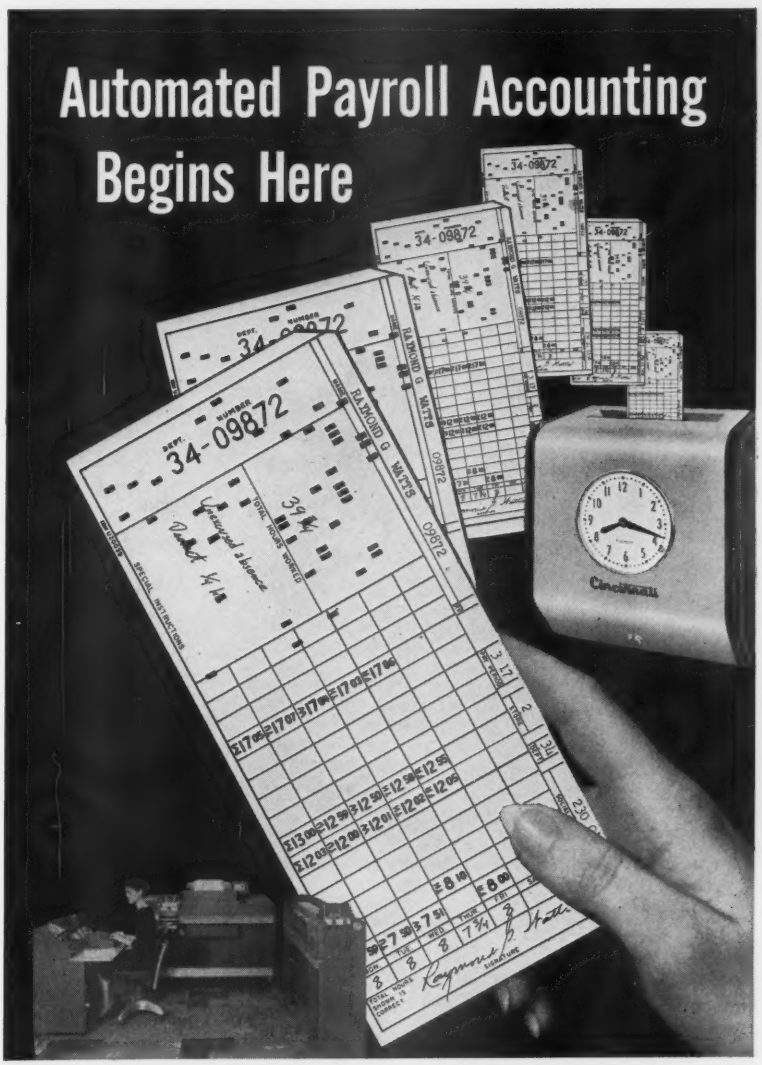

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CIA > NEWS

SENIOR AND JUNIOR AWARDS

TEN OF THE 14 PAST PRESIDENTS of the Toledo Control of Controllers Institute were honored recently by presentation of certificates of appreciation

In the group, reading from top left and right, downward, are:

William F. Webb, 1945-46
James B. Fenner, 1946-47
Eugene P. Heiles, 1947-48
Joseph V. Britt, 1948-49
Herbert E. Bremforder, 1952-53
Clarence C. Bower, 1951-52
Frank S. Slick, 1955-56
Robert W. Vogel, 1957-58
Harold B. Jackson, 1959-60
John R. Kahler, 1958-59

At the extreme lower right is **Stanley E. Ford,** 1960-61 president of the Toledo Control

JUNIOR ACHIEVEMENT of New York City recently arranged for the leading treasurers of its Junior Achievement-sponsored enterprises to gather in advance of the presentation of the award to the individual who had done the most outstanding job as treasurer of a Junior Achievement enterprise

The award to the treasurer, $100, is donated by the New York City Control of Controllers Institute.

This year's award winner was **Sandra Rubin** (third from the left). Standing, left to right, are **S. W. McLaughlin,** comptroller, West Virginia Pulp and Paper Company and vice president of the Eastern Area of Controllers Institute; **James J. Doyle,** director of finance, the Port of New York Authority, 1960-61 president of the New York City Control; and **W. A. Walker,** administrative vice president and comptroller, United States Steel Corporation and president-elect, 1961-62, of the New York City Control. Seated (center), is **Vincent Misuraca,** associate director, Junior Achievement of New York City.

• HENRY LA COSSITT, *public relations representative, Gulf Oil Corporation, Washington, D. C., presented this talk at the CIA Southern Area Conference at Houston, Texas*

Business and Politics

ONE OF THE CHARACTERS in Henrik Ibsen's play, "An Enemy of the People," makes the observation that politics is the most important thing in life. Although some may consider that a slight exaggeration and have other preferences, there is no doubt that it is, at least, *among* the most important. And almost anything said about politics, especially American politics, will be true. It is sordid and noble; absurd and meaningful; basely selfish and sublimely selfless—according to the individual or individuals involved.

Politics has been called the greatest of all games. It has also been defined as the art of the possible—that is, it is the art of getting things done. And because it is the art of the possible, the art of getting things done, the corporation which the writer represents announced some two and one half years ago that it was going to take an active part in politics.

Since at the time most corporations looked the other way and tried to be as inconspicuous as possible when politics was mentioned, this announcement caused quite a to-do. It inspired an astonishing number of comments—most of them favorable, some mildly critical, some downright hostile.

Some of the critics sounded the ancient bromide that politics was none of our proper business. They said, in effect, that politics was not the business of business. To this can be replied that politics is, or certainly should be, everybody's business.

More than 170 years ago, John Jay wrote in "The Federalist," the series of papers that had so much to do with the adoption of our Constitution:

> Nothing is more certain than the indispensable necessity of government, and it is equally undeniable, that whenever and however it is instituted, the people must cede to it some of their natural rights, in order to vest it with requisite powers.

This being true, as it patently is (the alternative is anarchy), it is obviously incumbent upon every citizen to understand his government in order that he may realize what rights he has ceded to it and what rights he has retained.

UNDERSTANDING IS BASIC

A corporation, in many ways, is like an individual. Like the individual, it cedes some of its rights to government and retains others. Like the individual, it enjoys privileges and is subject to the laws of the land. It is, indeed, simply a group of individuals banded together in a common enterprise that serves the public and the understanding that it and its people have of their rights, ceded and retained, is as important to it as it is to the private citizen. This understanding, in turn, is in direct ratio to a knowledge of political fundamentals and procedures.

This much is basic, but it is a deplorable fact, as almost endless surveys and statistics demonstrate, that relatively few Americans understand our system of government or are aware of what rights they have ceded to it, what rights they retain, and what their responsibilities are as free citizens.

Then there is the matter of the ballot box.

It is unfortunately true that about 80 per cent of us didn't vote in the 1959 off-year elections. In 1958, senators, congressmen, governors, state legislators, and so on, were elected. They are the men and women who have been taxing us, spending our money, regulating us, telling us—in many cases—how we can run our business, resolving our position in an uneasy and dangerous world. But 58.5 per cent of us seemed not to give a damn about it. And in 1960, with the presidency itself at stake, about 36 per cent of us apparently didn't care who won.

Incidentally, in this matter of voting, the last election provides pause. There are 166,137 election precincts in the United States and Mr. Kennedy's popular plurality was 112,881. This means that he won the highest office in the land by considerably less than one vote per precinct—and that is an important statistic whether you like what happened or deplore it.

Nobody can force an American to vote. It is his right to do so. It is also his right—shabby though it may be—not to do so. In Belgium, Switzerland, and some other nations, penalties, including fines, are imposed for failure to vote. But the American system leaves it up to the citizen who is, after all, self-governing, and free to do as he chooses in the matter.

A REGRETTABLE INDIFFERENCE

That is the way we want it, but we see how indifferent we can be in the matter. This indifference, regrettably, is as common to us in business as to people in any other community, even though, in our free economy, the business stake in politics and our political system is enormous. It is, indeed, as important as the capital on which we operate. We forget this at our peril. There is not—and never has been—a guarantee that private enterprise would continue to be the American economic system. It is not mentioned in our Constitution. It just happened—because our Constitution guarantees us our freedoms and we have made the most of them. But this has been possible only because of our political system. Private enterprise is a by-product of it and politics in general.

Still, some of the strongest champions of free enterprise seem to take particular pride in not knowing anything about politics and in not having anything to do with political matters. This is an attitude perilous. Politics is the foundation for our nation's free economic system and you cannot protect our economic system without paying close attention to the operations of our political system.

This seems fundamental, but until very recently business in the United States paid little or no attention to it. And if business has, in general, been respected and protected, this is due more to the inherent strength of our political system than to any efforts on the part of business leaders.

Like all generalizations, that one is exaggerated and there are many exceptions to it. Businessmen have been, and are, interested in politics and press hard for their interests; but in most cases they shift their political responsibilities to a wonderful variety of consultants, trade associations, committees and other individuals and organizations. In still others

(Continued on page 363)

Personal Notes

TOP MEN . . .

Robert L. Dickson has been elected president of Walter Kidde & Co., Inc., Belleville, N. J. Mr. Dickson is currently a trustee of Controllers Institute Research Foundation which he served as president in 1959-60. . . . **Albert L. Williams** was elected president of International Business Machines Corporation, New York.

Calif. . . . The appointment of **John A. Beckett** as administrative manager of Smith, Barney & Co., as well as treasurer of Smith Barney & Co. Incorporated, New York, was announced recently. . . . Now treasurer and chief financial officer of MacAndrews & Forbes Co., Camden, N. J., is **Richard F. Cadwallader.**

Edgar R. Coddington recently became controller of Plymouth Rubber Company,

Hills, Calif. . . . **H. K. Johnson** has joined General Industries Company, Elyria, Ohio, as treasurer. . . . The appointment of **F. P. Juraska** as controller of Melville Shoe Corporation, New York, was announced recently.

R. Visscher Millar is now controller of Universal Moulded Fiberglass Company, Bristol, Va. . . . **Robert J. Negri** was named controller of Diehl Manufacturing Company, Somerville, N. J. . . . **Charles L. Nielsen** was recently elected vice president-finance of Copper Range Co., Boston, Mass. . . . **Frank Z. Oles** has assumed the responsibilities of controller of Union Memorial Hospital, Baltimore, Md. . . . **William F. Palmer** has joined R. T. Vanderbilt Co., Inc., New York as controller.

Paul L. Pease is vice president-administration and control of Wrather Corporation, Beverly Hills, Calif. . . . **George T. Pfifer** is vice president and administrative officer of Universal Match Corpora-

MR. DICKSON

MR. CURRY

MR. JURASKA

MR. McCRACKEN

MR. SIDDALL

NEW CONNECTIONS . . .

Marvin Atlas is now controller of Stein, Hall & Company, New York. . . . **Bernard D. Beckerlegge** recently became vice president-finance of Capital Research and Management Company, Los Angeles,

Inc., Canton, Mass. . . . **Robert B. Curry** was appointed vice president-group executive of Remington Rand Division of Sperry Rand Corporation, New York. . . . **W. L. Heinrich** is vice president of Young Spring & Wire Corp., Beverly

tion, St. Louis, Mo. . . . **Henry W. Setzer** recently became treasurer and controller of Reinhard Brothers Company, Minneapolis, Minn. . . . Atkron, Inc., Cuyahoga Falls, Ohio, has appointed **William Skoda** as comptroller. . . . **Eugene J. Tanner** is assistant controller of Chance Vought Corporation, Dallas, Texas. . . . **W. Blake Thompson** recently became controller of Allegheny Airlines, Inc., Washington, D. C.

CHANGING YOUR ADDRESS?

Notice of change of address for THE CONTROLLER should be received in the editorial offices of THE CONTROLLER, Two Park Avenue, New York 16, N. Y., before the first of the month to affect the following month's issue. For instance, if you desire the address changed for your September issue, we should be notified of your new address before August 1. *Be sure to include your postal zone as well as your old and new address.*

COMPANY CHANGES . . .

The Procter & Gamble Company, Cincinnati, Ohio, announced the following changes in management effective July 1: **K. Y. Siddall** will retire after 35 years with the company. His responsibilities will be assumed by **Dean P. Fite** who will become vice president-corporate affairs. **C. K. McCracken** will assume the new title of vice president-finance. **Richard S. Runnels** will become comptroller of the company. Mr. Siddall is a past president and board chairman of Controllers Institute. Mr. McCracken is currently serving as an Institute Director.

Kraft Foods Division of National Dairy Products Corporation, Chicago, Ill., announced the appointment of **Gordon**

MR. EDWARDS

MR. KEILEY

MR. FILLASTRE

MR. HAGAMAN

MR. THARRINGTON

Edwards as executive vice president and **B. J. Keiley** as vice president. . . . The election of **Edward J. Tucker** as corporate controller and **William J. Corbett** as treasurer of American Airlines, Inc., New York, occurred recently. . . . **John E. O'Sullivan** was elected executive vice president of Indian Head Mills, New York. **James J. Gavin, Jr.** was elected vice president and treasurer to succeed Mr. O'Sullivan. . . . **Noel M. Fillastre** was appointed controller of Esso Standard Division of Humble Oil & Refining Company, New York, succeeding **Frederick P. Hagaman** who will retire on October 1.

PROMOTIONS . . .

Fred D. Bauce was appointed comptroller of Elliott Industries, Inc., Cambridge, Mass. . . . **H. L. Broadfoot** is now comptroller of the Des Moines, Iowa, plant of the Firestone Tire & Rubber Company. . . . The election of **J. Joseph Casey** as controller of Raymond International Inc., New York, was announced recently. . . . **Russell A. Clayton** is president of the International Division of Kaiser Aluminum & Chemical Corp., Oakland, Calif.

Elgin National Watch Company, Elgin, Ill., has elected **Harold F. Diegel** vice president and treasurer. . . . **Max R. Dodson** is executive vice president of Lone Star Steel Company, Dallas, Texas. . . . **Edward V. Ecklund** recently became treasurer of Acme-Hamilton Manufacturing Corp., New York. . . . Wheel Trueing Tool Co., Detroit, Mich., has named **Everett W. Harrison** controller. . . . **Howard W. Horne** has become controller of B. Lowenstein & Bros., Inc., Memphis, Tenn.

Recently named to the newly created post of general credit manager of Weyerhaeuser Company, Tacoma, Wash., is **Ken W. Hultgren.** . . . **Allen U. Hunt** is now vice president-finance of Top Value Enterprises, Inc., Dayton, Ohio. . . . **George D. Matson** has become vice president-finance and treasurer of Dixon Chemical & Research Inc., Bloomfield, N. J.

John McCambridge was recently elected vice president-finance of American Can Company, New York. . . . **E. W. Rawlings** is executive vice president for operations and finance of General Mills, Inc., Minneapolis, Minn. . . . The appointment of **Chester G. Gifford** as vice president and treasurer of Simoniz Company, Chicago, Ill., occurred recently. . . . **Robert W. Tharrington** has become assistant general manager of Aero-Space Division, Boeing Airplane Co., Seattle, Wash.

The new comptroller of the National Educational Television and Radio Center, New York, is **Diedrich J. Tietjen.** . . . **A. G. Treadgold** was elected treasurer of United Carbon Company, Houston, Texas. . . . **Duane E. Walton** was named assistant to the president and controller of Union Pump Company, Battle Creek, Mich. . . . **Louis E. Wengert** is general manager of the Direct Current Motor & Generator Department, General Electric Company, Erie, Pa. . . . **Donald E. Willerth** is controller of all plants of the Crayola Makers, New York.

EXTRACURRICULAR ACTIVITIES . . .

George N. Farrand, treasurer, Young & Rubicam, Inc., New York, was elected a director of the New York State Society of CPA's. . . . **Wayne C. Marks,** president of General Foods Corporation, White Plains, N. Y. was elected a member of the Board of Trustees of Pace College, New York. . . . **James R. McCoy,** dean of the College of Commerce and Administration, Ohio State University, was appointed to the Ohio Oil Company's Scholarship Committee for a term of three years. . . . **Robert L. Howard,** financial vice president and controller, Logan Company, Louisville, Ky., was named a division vice president of the National Association of Credit Management.

Robert H. Jarrell, comptroller and assistant secretary, Illinois Institute of Technology, Chicago, Ill., has been named chairman of the Education Section; Mercantile, Food and General Services Division of the over-all Business Division of the American Cancer Society. . . . **William G. Hodupp,** president Toledo Home Mortgages, Inc., was elected vice president of the Ohio Mortgage Bankers Association, a newly formed organization, in Columbus. . . . **Harley T. Pyles,** vice president and treasurer, Fairmont Aluminum Company, Fairmont, W. Va., was elected president of the Fairmont Rotary Club for 1961-62.

HONORS TO . . .

William R. Thomas, vice president-finance, Cutter Laboratories, Inc., Berkeley,

(Continued on page 362)

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Personal Notes *(Continued from page 361)*

Calif., and **Wilson K. Minor,** comptroller, Standard Oil Company of California, San Francisco, Calif., who were elected president and treasurer, respectively, of the California Business Administration Alumni Association. . . . **William J. Bates,** director of Methods and Procedures Division, Commercial Department, United States Steel Corporation, Pittsburgh, Pa., who was elected president of the International Systems and Procedures Association for 1961-62. . . . **Harry S. Mann,** controller, Walter Kidde & Company, Inc., Belleville, N. J., who was elected president of the Alumni Association of Stevens Institute of Technology, Hoboken, N. J.

MR. GOODWYN

MR. PIERCE

MR. TOOLE

ADDED RESPONSIBILITIES . . .

Harry J. Alverson, Jr. is now treasurer and controller of Firth Sterling Inc., Pittsburgh, Pa. . . . **Isidore Dlugin,** controller of H. Daroff & Sons, Inc., Philadelphia, Pa., is also controller of Botany Industries, Inc., New York. . . . The appointment of **Rudolph Epstein** as director of the Gruen Watch Company of Canada, Limited and election as vice president and treasurer was announced recently. . . . **W. Hugh Goodwyn** is now treasurer and controller of Larus & Brother Company, Inc., Richmond, Va.

Columbus & Southern Ohio Electric Co., Columbus, Ohio, has named **Arthur G. Green** as vice president and controller. . . . **Charles G. Horstman** has the responsibilities of vice president and comptroller of Royal Electric Corporation, Pawtucket, R. I.; he is also a director of the company. . . . **Albert L. Letourneau** has become vice president and comptroller of American Investment Company of Illinois, St. Louis, Mo. . . . **George E. Pierce** was elected vice president and secretary of the Buckeye Pipe Line Company, Houston, Texas. . . . **James F. Toole** was recently elected vice president and treasurer of Sperry Rand Corporation, New York.

AUTHORS . . .

William C. Flewellen, Jr., newly appointed dean of the School of Business and Industry at Mississippi State University, Starkville, Miss., is the author of *An Analysis of Cost Control Problems of Small Manufacturers in Alabama*—the first research study produced under the new program of the Small Business Administration.

SPEAKERS . . .

Among the speakers at the American Management Association Seminar on "Profit Planning with Budgetary Control" to be held July 10-14 at the Hotel Astor, New York, will be **Andrew W. Hughes,** comptroller, Rheem Manufacturing Company, New York, and **R. Visscher Millar,** controller, Universal Moulded Fiberglass Co., Bristol, Va. . . . **Willis T. Windle,** vice president and treasurer, Mohasco Industries, Inc., Amsterdam, N. Y., spoke at the AMA Seminar held June 14-16, Hotel Astor, on "Corporate Cash Management."

William G. von Berg, controller, Pfaudler Permutit Inc., Rochester, N. Y., was a speaker on "American Private Investment Abroad—Company Case Histories" at the Government-Industry Conference sponsored by the Machinery & Allied Products Institute at the Sheraton-Park Hotel, Washington, D. C., May 22-23.

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Business and Politics

(Continued from page 359)

they are content to contribute to the party of their choice—in some cases to both parties—and hope for the best in Washington, state capitals and city halls.

PAST EFFORTS OF BUSINESS

Some of these measures have, of course, been successful, and associations are valuable and necessary, but as far as politics is concerned, two things may be said about the business effort, such as it is. First, it generally has been against things, and then only when immediate interests were threatened; second, it has by and large resulted only in business carrying on a commiserating conversation with itself.

And what has been the result? Well, we hear a great deal about "a favorable business climate." *But who can doubt that while this climate is still fundamentally favorable, heavy weather is forecast and storm signals are flying?* In the industry which the writer represents, certainly, this is true. Whereas ten years or so ago we had very few problems where public affairs are concerned, today we are on the defensive, beset, under attack. This is more or less true with other industries as well.

Nor is this so because of any real change in the attitude of Washington officials toward free enterprise. On the contrary, it is even possible to say that as the oil industry's public position deteriorated, people in the several branches of the Federal Government came to be more—not less—devoted to the free enterprise principle.

What happened is that the industry itself, by indifference, or carelessness—or both—has permitted misconceptions and misunderstandings about oil to go unchallenged, until today we find that our case must be presented very often in the face of openly hostile public opinion, or, at the very least, without the support or the interest of public opinion.

And public opinion reflects itself—as it should—in politics and the political community. Therefore, when it is set against industry, either by design or because of ignorance, we find our political position precarious and, as it is today, deteriorating.

THE PROGRAM AT GULF

So what to do about it? Well, in Gulf's case, the decision was made to undertake its own political program.

The program is designed to close the gap that lies between the businessman on the one hand and public opinion and the political community on the other. It is a positive program, based, first, on the solid premise that what is good for the community is good for the company. And it is *for* things, and not merely against them. Through it we are trying to instruct company personnel, shareholders, and others connected with the corporation in the matter of their rights and responsibilities as free citizens.

The program is nonpartisan. We urge our people to be active—as many are today—in the party of their choice. But more than this—which is not, after all, a novel idea—we urge our people to interest themselves in civic affairs. The local community is the level on which we base our operation because that is where public opinion is most important. We urge our people to take an interest in local affairs on the precinct level, even on the block level, and to support local projects that are in the public interest.

The list of these is long and varied. If, for example, the citizens of a Texas town were faced with a water problem, we would want our local Gulf people to lend their time and talents in helping to solve it. Or it may be the case of one of those New England communities attempting to rehabilitate itself by bringing in new industry to replace units that have moved away. Or the development of an area's master plan, a public authority, or any other worthy civic enterprise. And certainly we want our people to work in primary election campaigns for the best possible candidates.

If the case is important enough, we make available our employes to devote their full time to the civic project in question. The point is that Gulf wants its people and their wives to participate vigorously in community affairs.

THE RECORD OF ACCOMPLISHMENT

Now what have we accomplished? Well, let it be said at the outset that we are making haste slowly. This must necessarily be the case in an organization as large and widespread as Gulf. We are trying not to make mistakes. Nevertheless, we have made considerable progress. We have regional representatives at work on the program in key cities around the nation, such as Philadelphia, New York, Atlanta, Jackson, Houston, Toledo, Los Angeles, Denver, New Orleans and elsewhere. Each is charged with the responsibility of inspiring and supervising the activities of company people in his area, down to the precinct level. It is their duty to help corporate and allied personnel to select worthy projects and issues and to see that action is taken on them.

In Philadelphia, for example, a series of public affairs conferences is under way. At the first of these, Mayor Richardson Dilworth lent his presence and prestige before 150 Gulf men and their wives and explained the city's problems to them. Also on that program were the top men of the area's two principal developmental organizations, both of which Gulf people are assisting. In Houston, a very active Gulf Women's Club is working on community projects. *(Turn to next page)*

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Financial-Systems Analyst-CPA

Corporation administrative executive offers top-level extensive background functioning with management group. Practical experience includes organization planning, banking relations, acquisitions-mergers, SEC reports; developing expansion and cost-expense reduction programs, analyzing and interpreting costs, budgets, systems and surveys, all taxes. Multi-plant process industries, transportation, chain stores, securities, real estate, financing enterprises. Box 2431.

ADMINISTRATIVE EXECUTIVE

MIT graduate with 15 years' experience in all phases of administrative and internal financial functions. Also well oriented in marketing and distribution problems. As corporate officer of small multiplant manufacturing corporation performed controller duties, managed accounting functions. Installed systems, including IBM and standard costs; handled tax and corporate matters. Married, age 40. Box 2508.

CONTROLLER/FINANCIAL EXECUTIVE

Well-qualified and fully experienced executive with 14 years of highly diversified experience in all phases of complex corporate accounting/controllership and finance, is seeking an organization that would benefit by a vigorous profit improvement program developed through comprehensive financial planning, including the establishment of budgets and budgetary control techniques and the construction and integration of a total information reporting system utilizing financial and statistical reporting programs adapted to data-processing applications. Currently employed as assistant controller/assistant treasurer of a major, multiplant, multi-corporate listed organization with revenues approximating $140 million annually. Member CIA. Will relocate. Resume on request. Box 2512.

CONTROLLER
ASSISTANT CONTROLLER
ASSISTANT TREASURER

CPA, B.A. Six years public accounting; eight years industrial, six as controller multiplant food organization. Responsible all normal functions controller position. Will relocate. Age 39. Resume on request. Box 2515.

CONTROLLER-TREASURER

Assistant controller of old, growing $200 million manufacturer is seeking top responsibility in finance and/or accounting with medium-sized company. Experienced administrator for all office functions, EDP, acquisitions, planning. Member CIA. Age 44. Resume on request. Box 2516.

NOTE: THE CONTROLLER reserves the right to accept, reject or censor classified copy and takes no responsibility for the people contacted through this column nor does it guarantee any item bought or sold.

And all around the country we find Gulf people on civic committees, active in community affairs generally and, incidentally, schooling themselves in practical politics by taking courses in the subject offered by the Chamber of Commerce, the Effective Citizens' Organization and others. Recently, indeed, a Gulf distributor in Williamsport, Pennsylvania, was elected to Congress from his state's 17th District. Some of our people are serving as mayors, others as commissioners, city committeemen, precinct and county committeemen, school board officials—the list is long and gratifying.

Our Washington office, established last year, tries to keep the regional representatives and, indeed, the entire company, its shareholders, and dealers informed of national trends and gives help where it is needed. Through the pages of company publications we give information on political events and procedures; through newsletters we analyze bills, provide voting records, and report political and economic trends.

We endeavor to educate our people in the field of public affairs with particular respect to their own communities because that is where public opinion begins.

DUAL NATURE OF THE PROGRAM

But our program really is divided by two. One is the broad field of public affairs and community relations; the other is the field of hard, practical politics. Naturally, we continue to lobby for our corporate interests in Washington, state capitals, and in city halls. The two parts of the program, therefore, complement each other because, if we improve public opinion where our company is concerned, we surely will improve political opinion.

There is no company dictation in the program. A man's conscience is his own; his beliefs are his own; and he may act on them, or not, as he pleases. We do our best to persuade him that such activity is in his own interest, as well as that of the corporation; we cannot force him to such a course, nor have we any desire to do so.

Similarly, if a man's political opinions happen not to agree with those expressed by the company brass, that, too, is his affair. His willingness to work for what he considers to be the right is respected.

Critics of our program, and of the business-in-politics movement, have implied, or stated outright, that it is aimed at labor. They have assumed that if business goes into politics it necessarily must be against COPE and other labor political organizations. The fear has been expressed that this will result in big business being arrayed against big labor.

It may be that we invited this reaction. It is true that we were disturbed, not by labor's political action, but by what seemed to us to be a disproportionate power achieved through this political action, and we so expressed ourselves. But we have come to see that, if politics is everybody's business—and it is—labor is simply doing its job.

George Meany, president of the AFL-CIO, has said "I see no harm in power, if it is power dedicated to human values, if it is power dedicated for good—and that is what the trade-union movement seeks."

We find ourselves in agreement with Mr. Meany. We seek the same things. And if labor can do its job, so can business. Our program is aimed at nobody and is not—emphatically not—a program of reprisal. If it were, it would be doomed before it was started. Even if we wanted to—which we do not—we could not deliver votes *en bloc*. And if we tried to do so our 161,000 employes, shareholders, and dealers would have every right to resent it and to ignore us.

We welcome labor's participation in politics because that is their right and their responsibility. Actually, our program and those of other corporations should bring labor and management into a new area of understanding because of political activities. This is because it is inevitable, in the course of events, that we often will find ourselves working side by side for the same causes.

THE CORPORATION'S AIMS

Now it may be asked: *Just what does the corporation expect to gain from all this?* The answer is that the corporation, like the individual, has its obligation to the community. Our program attempts to discharge this obligation. "The health of a democratic society," wrote Alexis de Tocqueville some 130 years ago, "may be measured by the quality of functions performed by its citizens." Through our new program we try to pay particular attention to the quality of such functions. And if, by doing this, we demonstrate our good citizenship, that certainly cannot be to our disadvantage in a political or economic sense.

To sum up, we are carrying out the program described because we consider it our right and our responsibility to participate in politics and because we want our corporation and its personnel, stockholders, and dealers to discharge their duties as citizens.

"I know of no safe depository of the ultimate powers of society but the people themselves," wrote Thomas Jefferson. The late mayor of the city of Chicago, Ed Kelly, put it a little differently. "Politics," he said on one occasion, "is people."

Our corporation is made up of people. If they exercise their "ultimate powers" in the public interest we will be more than satisfied because, as noted before, what is good for the community is bound to be good for the company. And they will create that favorable public and political opinion without which no organization of whatever nature can flourish and prosper.

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